15

No. 89-1452-CFX
Status: GRANTED

Title: Mobil Oil Exploration & Producing Southeast Inc., et al., Petitioners
v.
United Distribution Companies, et al.

Docketed:
March 15, 1990

Court: United States Court of Appeals for the Fifth Circuit

Vide:
89-1453

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Entry	Date	Note	Proceedings and Orders
1	Jan 10 1990	P	Application (A89-503) for a stay, submitted to Justice White.
2	Jan 10 1990		(A89-503) Order by Justice White granting a stay of mandate in United States Court of Appeals for the Fifth Circuit, case No. 86-4940, pending receipt of responses to the application and further order of the undersigned or of the Court.
3	Jan 10 1990		(A89-503) Application for stay referred to the Court by Justice White. JANUARY 12, 1990 CONFERENCE.
4	Jan 11 1990		Response to application (A89-503) filed by Williams Natural Gas Company.
5	Jan 11 1990		(A89-503) Response to application filed by state commissions, consumers' counsel, consumer organizations, natural gas distribution companies and interstate natural gas pipelines.
6	Jan 11 1990		(A89-503) Response supporting application filed by Federal Energy Regulatory Commission.
7	Jan 12 1990		(A89-503) Reply to response of FERC filed by Williams Natural Gas Company.
8	Jan 16 1990		(A89-503) Application for stay of mandate of the United States Court of Appeals for the Fifth Circuit granted by Court pending timely filing and disposition of petition for writ of certiorari.
9	Mar 15 1990	G	Petition for writ of certiorari filed.
11	Mar 23 1990		Order extending time to file response to petition until May 14, 1990.
12	Apr 5 1990		Brief of respondents Process Gas Consumers Group, et al. in support of petition filed. VIDED.
13	Apr 16 1990		Brief amicus curiae of Louisiana filed. VIDED.
15	May 14 1990		Brief of respondents United Distribution Companies, et al. in opposition filed. VIDED.
14	May 15 1990		DISTRIBUTED. May 31, 1990
16	May 17 1990	X	Reply brief of petitioners Mobil Oil, et al. filed.
17	Jun 4 1990		Petition GRANTED. **
18	Jun 13 1990		Record filed.

No. 89-1452-CFX

Entry	Date	Note	Proceedings and Orders
		*	Certified copy of original record and proceedings received. (Box). Vide 89-1453.
20	Jun 21 1990		Order extending time to file brief of petitioner on the merits until August 9, 1990.
21	Aug 9 1990		Joint appendix filed. VIDED.
22	Aug 9 1990		Brief amici curiae of New Mexico, et al. filed. VIDED.
23	Aug 9 1990		Brief amicus curiae of Washington Legal Foundation filed. VIDED.
24	Aug 9 1990		Brief amicus curiae of Interstate Oil Compact Commission filed. VIDED.
27	Aug 9 1990		Brief of petitioners Mobil Oil, et al. filed. VIDED.
28	Aug 9 1990		Brief of petitioner FERC filed. VIDED.
26	Aug 15 1990		Order extending time to file brief of respondent on the merits until October 1, 1990.
29	Aug 20 1990	G	Motion of petitioners for divided argument filed.
30	Sep 14 1990	G	Application (A90-216) by respondents to file a brief on the merits in excess of page limits, submitted to Justice White.
31	Sep 18 1990		Application (A90-216) granted by Justice White, allowing a maximum of 70 pages.
35	Sep 26 1990		SET FOR ARGUMENT MONDAY, NOVEMBER 5, 1990. (1ST CASE)
32	Oct 1 1990		Motion of petitioners for divided argument GRANTED.
33	Oct 1 1990		Brief of respondents United Distrib., et al. filed. VIDED.
34	Oct 3 1990		CIRCULATED.
36	Oct 25 1990	X	Reply brief of petitioners Mobil Oil, et al. filed. VIDED.
37	Oct 29 1990	X	Reply brief of petitioner FERC filed. VIDED.
38	Nov 5 1990		ARGUED.

① 89- 1452

No. ______

IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

MOBIL OIL EXPLORATION & PRODUCING SOUTHEAST, INC., *et al.*,
Petitioners,

v.

UNITED DISTRIBUTION COMPANIES, *et al.*,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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QUESTION PRESENTED

Whether the court of appeals exceeded its reviewing authority or otherwise erred in vacating a nationwide program of the Federal Energy Regulatory Commission designed to increase production of low-cost natural gas and to eliminate severe distortions caused by the pre-existing ceiling price structure applicable to "old gas," *i.e.*, gas in the interstate market from wells drilled prior to 1977. Specifically, whether the court of appeals applied an improper standard or otherwise erred:

(1) in setting aside, without regard to the plain statutory language and based solely on the court's reading of the legislative history, the Commission's determination that the Natural Gas Policy Act of 1978 permits the Commission to modify the pre-existing pricing scheme by setting a single, higher ceiling price for old gas;

(2) in setting aside the Commission's determination that the Natural Gas Act authorizes the Commission to specify by rule, rather than case-by-case adjudication, the circumstances in which the Commission will permit abandonment of a facility or service subject to its jurisdiction; and

(3) in requiring the Commission to solve, in *this* proceeding, another natural gas policy issue already being addressed in other proceedings—the issue of "take-or-pay" provisions in gas contracts—as a precondition to the Commission's effort to resolve the problem of old gas pricing.

LIST OF PARTIES

A list of parties and the statement required by Rule 29.1 are included in Appendix F to this petition. App., *infra*, 76a-82a.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

No. ———

MOBIL OIL EXPLORATION & PRODUCING SOUTHEAST, INC., *et al.*,
Petitioners,

v.

UNITED DISTRIBUTION COMPANIES, *et al.*,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Petitioners hereby petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Fifth Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-36a), together with the dissenting opinion of Judge Brown (App. 36a-57a), is reported at 885 F.2d 209 (5th Cir. 1989). Order No. 451 of the Federal Energy Regulatory Commission is reprinted at 51 Fed. Reg. 22,168 (1986) and III FERC Stats. & Regs. (CCH) ¶ 30,701 (1986). Order No. 451-A of the Federal Energy Regulatory Commission is reprinted at 51 Fed. Reg. 46,762 (1986) and III FERC Stats. & Regs. (CCH) ¶ 30,720 (1986).

JURISDICTION

The judgment of the court of appeals was entered on September 15, 1989. Rehearing was denied on December 15, 1989. App. 58a. This Court has jurisdiction under 28 U.S.C. § 1254(1). On January 16, 1990, this Court granted a stay of the mandate of the court of appeals

pending the timely filing of a petition for certiorari. App. 60a.

STATUTES AND REGULATIONS INVOLVED

Section 104(b)(2) of the Natural Gas Policy Act of 1978, which in all relevant respects is identical to Section 106(c) of the same Act, provides:

> **Ceiling prices may be increased if just and reasonable**—The Commission may, by rule or order, prescribe a maximum lawful ceiling price, applicable to any first sale of any natural gas (or category thereof, as determined by the Commission) otherwise subject to the preceding provisions of this section, if such price is—
>
> (A) higher than the maximum lawful price which would otherwise be applicable under such provisions; and
>
> (B) just and reasonable within the meaning of the Natural Gas Act.

15 U.S.C. § 3314(b)(2); see also 15 U.S.C. § 3316(c).

Section 7(b) of the Natural Gas Act of 1938 provides:

> No natural-gas company shall abandon all or any portion of its facilities subject to the jurisdiction of the Commission, or any service rendered by means of such facilities, without the permission and approval of the Commission first had and obtained, after due hearing, and a finding by the Commission . . . that the present or future public convenience or necessity permit such abandonment.

15 U.S.C. § 717f(b).

The regulations adopted or amended pursuant to Orders No. 451 and 451-A are reproduced in the Appendix. App. 61a-75a.

STATEMENT

This case concerns the exhaustive efforts of the Federal Energy Regulatory Commission ("Commission" or "FERC") to develop a rational and efficient nationwide program for regulating prices of "old" natural gas, *i.e.*,

gas in the interstate market from wells drilled prior to 1977. That gas accounted for approximately 40 percent of the nation's production at the time of the Commission's decision. After lengthy deliberations over an extensive administrative record, the FERC adopted Orders No. 451 and 451-A (collectively "Order 451"), a carefully crafted set of regulations designed to reduce the serious market distortions and adverse effects on consumers created by the prior old gas pricing scheme. Those regulations formed the basis for a major restructuring of contractual relationships throughout the natural gas industry, a restructuring that involved the renegotiation of at least 3,000 contracts covering some seven trillion cubic feet of old gas. After more than three years of operation, however, the FERC's regulatory program was overturned by a sharply divided court of appeals, which held that the FERC lacked the authority to implement that program. If left in place, the court of appeals' decision not only would threaten the Commission's authority to resolve this and other regulatory issues within its jurisdiction, but also would cause severe dislocations throughout the natural gas industry by disrupting the salutary market restructuring that Order 451 has produced.

1. Historically, natural gas prices have been regulated principally under the Natural Gas Act of 1938 ("NGA"). 15 U.S.C. §§ 717-717w. Beginning in the 1960s, the Federal Power Commission ("FPC"), acting pursuant to the NGA, instituted a system of area-wide wellhead ceiling prices for natural gas. These ceiling prices were set pursuant to a system of "vintage" pricing under which one ceiling price was established for gas that had already been dedicated to interstate commerce—what was then considered "old" gas—and another, higher ceiling was established for "new" gas. Originally, the vintage pricing system was intended to be a mechanism for increasing natural gas supplies through higher ceilings on new gas, while moderating price increases to consumers through lower ceilings on existing supplies. See Opinion

No. 468, 34 F.P.C. 159, 185-88 (1965); see also 51 Fed. Reg. at 22,168, 22,173; App. 9a.

From the outset, both the FPC and the courts consistently treated vintage pricing as a temporary expedient, which the FPC, exercising its broad discretion under the NGA, remained free to modify or eliminate as experience and regulatory needs changed. See Statement of General Policy, No. 61-1, 24 F.P.C. 818, 819 (1960) ("It is anticipated that these differences in price levels will be reduced and eventually eliminated."). In upholding the FPC's system of area rates, for example, this Court made clear that the NGA does not prescribe any particular regulatory formula or methodology, including vintaging. *Permian Basin Area Rate Cases*, 390 U.S. 747, 775-77, 799-800 (1968). For that reason, the FPC received judicial approval when it implemented its 1972 conclusion that vintaging was "an anachronism which we should now move to eliminate." See Opinion No. 639, 48 F.P.C. 1299 (1972), *aff'd sub nom. Shell Oil Co.* v. *FPC*, 491 F.2d 82, 88 (5th Cir. 1974); Opinion No. 699-H, 52 F.P.C. 1604, 1631-32 (1974), *aff'd sub nom. Shell Oil Co.* v. *FPC*, 520 F.2d 1061 (5th Cir. 1975), *cert. denied*, 426 U.S. 941 (1976). The court of appeals also approved when the FPC, having reinstated vintaging in 1976, consolidated a numbe· of the most outdated vintages into a single vintage category for all gas flowing prior to 1972. Opinion No. 749, 54 F.P.C. 3090 (1975), *aff'd sub nom. Tenneco Oil Co.* v. *FERC*, 571 F2d 834 (5th Cir), *cert. dismissed*, 439 U.S. 801 (1978). Despite that consolidation, the FPC's vintage pricing structure still contained 16 different categories of old gas—each with its own ceiling price—when the FERC inherited the FPC's regulatory authority in 1977. 51 Fed. Reg. at 22,170.

2. The vintage pricing structure contributed to the acute gas shortages experienced in the interstate market during the 1970s. Ceiling prices on many categories of gas were artificially low. Artificially low prices, in turn, generated a steady increase in demand for natural gas while at the same time reducing the supply available

to the interstate market. This reduction in supply was exacerbated by intense competition from an unregulated intrastate gas market, as well as by the ever-increasing costs of exploring for and developing new gas supplies. Periodic rate reviews by the FPC and the FERC, moreover, failed to keep up with this fast-changing market.[1]

In an effort to eliminate gas shortages in the interstate market as well as to streamline and rationalize the regulatory process, Congress in 1978 enacted the Natural Gas Policy Act ("NGPA"), which "dramatically changed the method of pricing natural gas produced in the United States." *Public Service Comm'n* v. *Mid-Louisiana Gas Co.*, 463 U.S. 319, 322 (1983). Contrary to the assumption of monopoly power on which the prior regulatory regime had been built, Congress determined that the producing segment of the natural gas industry was workably competitive. *Transcontinental Gas Pipe Line Corp.* v. *State Oil & Gas Bd.*, 474 U.S. 409, 420 (1986); *Pennzoil Co.* v. *FERC*, 645 F.2d 360, 378 (5th Cir. 1981), *cert. denied*, 454 U.S. 1142 (1982). Accordingly, Congress immediately provided higher prices for "new" natural gas and put into place a scheme of phased deregulation for most of that gas. 92 Stat. 3350 (codified at 15 U.S.C. §§ 3301 *et seq.*).

Congress, however, did not restructure the pre-existing ceiling prices for old gas. Instead, in NGPA Sections 104 and 106, Congress simply adopted the ceiling prices that had been established by the Commission and made them subject to an automatic inflation adjustment. *Id.* §§ 3314(b)(1), 3316(a). But, even with this adjustment mechanism, "the statute recognize[d] that the ceiling[s] may be too *low* and authorize[d] the Commission to raise" them pursuant to certain statutory criteria. *Public Service Comm'n* v. *Mid-Louisiana Gas Co., supra*, 463 U.S. at 333 (emphasis in original). Specifically, Sec-

[1] See generally S. Williams, *The Natural Gas Revolution of 1985* 1 (1987); Pierce, *Reconstituting the Natural Gas Industry From Wellhead To Burnertip*, 9 Energy L.J. 1, 8-11 (1988).

tions 104(b)(2) and 106(c) expressly authorized the Commission, "by rule or order," to change the ceiling prices for "any natural gas . . . or category thereof . . . otherwise subject to [Sections 104 and 106]," conditioned only by the requirements that the new ceiling be (1) *higher* than the ceilings set by the NGPA, and (2) "just and reasonable" within the meaning of the NGA. *Id.*

3. By 1985, the gas shortages of the 1970s had given way to excess supply. Yet the expected consumer benefits of this increase in supply—lower prices—had failed to materialize, largely because of the existing old gas pricing structure.[2] Accordingly, in a 1985 notice of proposed rulemaking, the Secretary of Energy urged the Commission to eliminate vintage pricing of old gas. 50 Fed. Reg. 48,540 (1985).[3] According to the Secretary, vintage pricing of old gas had produced a number of adverse effects on the natural gas market and on the Nation's economy:

First, artificially low old gas prices under the vintage pricing system were causing producers to abandon production from old wells in favor of investment in new wells, which, although more expensive, were more profitable to producers because of higher price ceilings. 50 Fed. Reg. at 48,543. The Secretary estimated that 23 to 44 trillion cubic feet (Tcf) of old gas (one to two years' supply) would be permanently lost as a result. 50 Fed. Reg. at 48,540-541, 48,543.

Second, vintage pricing of old gas was causing increased reliance on imported gas and imported oil, thereby contributing to a deterioration in the Nation's balance

[2] See, *e.g.*, S. Williams, *supra*, at 3-9; J. Kalt & F. Schuller, *Drawing the Line on Natural Gas Regulation* 4-8 (1987); P. Carpenter, H. Jacoby & A. Wright, *Adapting to Change in Natural Gas Markets* (1986); Pierce, *supra*, at 12-13.

[3] Pursuant to section 403 of the Department of Energy Organization Act (42 U.S.C. § 7173(a)), the Secretary of Energy is authorized "to propose rules, regulations, and statements of policy of general applicability with respect to any function within the jurisdiction of the Commission. . . ."

of payments. 50 Fed. Reg. at 48,545. According to the Secretary, full recovery of old gas reserves would reduce imports of natural gas by $5 to $7 billion from 1985 to 1995, and would also reduce imports of oil by 300,000 to 350,000 barrels *per day* (worth about $7.5 to $8.8 million per day), thereby reducing "our vulnerability to oil supply disruptions." 50 Fed. Reg. at 48,544-545.

Third, vintage pricing of old gas was bad for consumers because it forced them to pay more for natural gas, on average, than they would absent the distortions created by the vintaging system. 50 Fed. Reg. at 48,543-544. According to the Secretary, full recovery of old gas supplies would "lower average consumer prices by $0.19 to $0.55 per Mcf [thousand cubic feet] from June 1985 to 1995." 50 Fed. Reg. at 48,543-544.

Fourth, apart from increasing gas prices to the average gas consumer, vintage pricing of old gas had created a "gargantuan inequity" in the treatment of consumers in various parts of the country because it forced consumers whose suppliers did not have significant inventories of low-priced old gas to pay substantially more than other gas customers. 50 Fed. Reg. at 48,541-542. These regional disparities, in turn, were giving industrial users in some regions of the country an artificial and unfair advantage over their competitors in other regions, and were forcing some groups of consumers to bear a disproportionate share of the costs of locating and recovering new gas supplies. 50 Fed. Reg. at 48,541-542.

In sum, according to the Secretary, vintage pricing of old gas was an "unnecessary anachronism" that can be understood only as an "accident of an historic ratemaking process that was ultimately unsuccessful in accomplishing its stated objectives of ensuring an adequate supply of natural gas for consumers at reasonable prices while providing a reasonable return and incentive for producers." 50 Fed. Reg. at 48,542. The Secretary therefor urged the Commission to use its authority under

Sections 104(b)(2) and 106(c) to eliminate vintage pricing of old gas by increasing the maximum lawful price for all old gas to the existing ceiling price for the post-1974 old gas vintage. 50 Fed. Reg. at 48,545.

4. The Commission analyzed approximately 113 sets of comments and held two days of public hearings on the Secretary's proposal. Then, in Order 451 (later clarified in Order 451-A), it adopted a modified version of the Secretary's proposal that went into effect on July 30, 1986.

The Commission found that the existing vintage pricing system for old gas was inhibiting production and creating serious market distortions. The Commission expressly found that vintage pricing of old gas was inequitable because it required consumers in some areas to pay substantially more than similarly situated consumers in other areas. 51 Fed. Reg. at 22,172, 46,766.[4] The Commission also agreed with the Secretary's assessment of the system's inequitable effects on industrial users. 51 Fed. Reg. at 22,182-183, 46,765-766. The Commission further found that, because of the pipelines' ability to "roll in" prices of higher-cost gas supplies with those of lower-cost supplies, consumers were not realizing the benefits of artificially low prices for old gas. 51 Fed. Reg. at 22,172, 46,766. Finally, the Commission found that the maintenance of artificially low prices for old gas, which is relatively less expensive to produce, was skewing development and recovery efforts away from that gas,

[4] The Commission noted, for example, that consumers in the Washington, D.C. area were paying their local distribution companies $8.05/Mcf, while consumers in Kansas, whose suppliers have access to substantial old gas, were paying $4.49/Mcf. See 51 Fed. Reg. at 22,172; see also App. 39a-40a n. 2 (Brown, J., dissenting). The Commission also found that, by substantially reducing average consumer prices, the elimination of vintage pricing of old gas would reduce prices to the vast majority of consumers, even though in the short run it might increase prices in a few regions where gas prices were artificially low. See 51 Fed. Reg. at 22,195-204.

resulting in its premature abandonment. 51 Fed. Reg. at 22,172, 46,766. The Commission conservatively estimated that, during the following decade, the elimination of vintage pricing of old gas would lead to the production of 11 Tcf of additional old gas, resulting in savings to consumers of approximately $25 billion. 51 Fed. Reg. at 22,172, 46,766; 50 Fed. Reg. at 48,540. Accordingly, the Commission expressly found that the existing vintage pricing structure for old gas (including the specific ceiling prices applicable to pre-1974 vintages) was unjust and unreasonable. 51 Fed. Reg. at 22,182, 46,766.

The new regulatory regime for old gas created by Order 451 contained two principal elements relevant here. First, acting pursuant to its express authority under Sections 104(b)(2) and 106(c) of the NGPA, the FERC established a single ceiling price applicable to all vintages of old gas.[5] The maximum price was set at the ceiling price for the post-1974 old gas vintage. The Commission adopted the post-1974 ceiling price because it concluded, based upon several cost studies, that this price most closely approximated the true replacement cost of gas. See 51 Fed. Reg. at 22,185, 46,768. The Commission also found that this new ceiling price was a just and reasonable price for all gas subject to Sections 104 and 106 because, inter alia, that price fell within the "zone of reasonableness" established by the cost studies. 51 Fed. Reg. at 22,182-185, 46,766-768. The Commission,

[5] In so doing, the FERC did not abrogate the prior ceilings because significant conditions had to be met before a producer could collect the new maximum price. See *infra* 10-12. For that reason, the FERC referred to the new ceiling as an "alternative ceiling price." *E.g.*, 51 Fed. Reg. at 22,168. Moreover, the FERC did not eliminate the overall vintage pricing structure established in the NGPA; instead, the ceiling price for old gas remained below the ceilings applicable to the other categories of gas (*e.g.*, "new" gas) subject to price regulation under the NGPA. See, *e.g.*, 51 Fed. Reg. at 22,176-177, 46,765. The Commission merely consolidated all of the multiple vintage categories—or "subvintages"—of old gas into a single vintage category subject to a single ceiling price, thereby eliminating vintaging *within* the category of gas covered by Sections 104 and 106.

however, stated that producers would be permitted to collect a price above the old ceiling *only* if the particular contract at issue permitted a higher price. 51 Fed. Reg. at 22,204, 46,784.

Several times the Commission expressly addressed the scope of its authority under Sections 104(b)(2) and 106(c) to set a single ceiling price for all old gas. The Commission concluded that its action was authorized by Congress because "the express and unambiguous terms" of those provisions "specifically authorize the Commission to raise old gas prices, subject only to the requirement that the Commission find that the higher rates are just and reasonable within the meaning of the NGA." 51 Fed. Reg. at 22,179.[6] The Commission also rejected suggestions by several opponents of the DOE proposal that excerpts from the Senate and House debates on the NGPA indicated a congressional intent to preclude the FERC from eliminating vintage pricing of old gas. 51 Fed. Reg. at 22,179, 46,764-765.[7] The Commission also rejected ar-

[6] See also 51 Fed. Reg. at 22,171 ("Congress expressly gave the Commission further authority to raise even those prices [set by Congress in Sections 104 and 106], provided the result would be just and reasonable under the NGA"); 51 Fed. Reg. at 22,174 ("[T]he NGPA authorized the Commission in its discretion to revise old, flowing gas rates—as long as it revised the rates up, not down, and as long as it determined that such revised rates were 'just and reasonable within the meaning of the Natural Gas Act'"); 51 Fed. Reg. at 46,764 ("the terms of section 104(b)(2) and 106(c) are unambiguous and specifically authorize the Commission to modify the prices and price structure of old gas, subject only to the just and reasonable standard of the NGA"); 51 Fed. Reg. at 46,764 ("authority granted to the Commission . . . to increase old gas prices . . . is too clear to admit any doubt").

[7] For example, opponents of DOE's proposal cited a floor statement by Senator Domenici stating that elimination of vintaging "is not in this bill." 124 Cong. Rec. S28,865 (Sept. 12, 1978). However, the Commission pointed out that this statement "on its face" does not refer to "the *regulatory* revision of ceiling prices under NGPA sections 104(b) and 106(c)." 51 Fed. Reg. 22,179 (Sept. 12, 1978) (emphasis in original). See also *id.* (reproducing letter from

guments that it was in effect "deregulating" old gas: It observed that it was retaining both (a) a ceiling price applicable to that gas and (b) the authority to change that ceiling price—or even reinstate vintage pricing—if it determined that the ceiling price was no longer just and reasonable. See, *e.g.*, 51 Fed. Reg. at 22,211, 46,764-765.

As its second principal element, Order 451 requires producers to enter into negotiations with their pipeline purchasers before they can collect a higher price, even when the parties' existing contract would permit the producer to collect a price higher than the prior ceiling price. 51 Fed. Reg. at 22,204, 46,784. If the parties are unable voluntarily to negotiate a new or amended contract price, Order 451 specifies a structured "good faith negotiation" ("GFN") procedure with which producers must comply before charging a price in excess of the prior ceiling. 51 Fed. Reg. at 22,204, 46,784. To provide pipelines with additional bargaining power, Order 451 grants them the right, in response to invocation of the GFN procedure by a producer, to require the producer to renegotiate the prices previously agreed upon for any other gas (including new gas, deregulated gas and "high-cost" gas) under any contract that covers at least some old gas. 51 Fed. Reg. at 22,204-206.

The Commission also held that in those instances where parties are unable to agree on a new price for sales of old gas after compliance with the GFN procedures, abandonment of the existing service obligation by both the producer and the pipeline satisfies all the requirements of Section 7(b) of the NGA. That provision prohibits abandonment of services rendered under the Commission's jurisdiction "without the permission and approval

Sen. Domenici to FERC explaining that his statement was limited to describing what Congress was doing in the statute, not what FERC could do pursuant to the statute).

of the Commission first had and obtained, after due hearing, and a finding by the Commission . . . that the present or future public convenience or necessity permit such abandonment." 15 U.S.C. § 717(f). In accordance with the statutory requirement, the Commission found that abandonment of purchase and sale obligations following a failure to reach agreement under the GFN process would further the public convenience and necessity. 51 Fed. Reg. at 22,205. The Commission also concluded that the "due hearing" requirement of Section 7(b) "does not require that the Commission hold individual case-by-case hearings" provided that the abandonment satisfies pre-established criteria and those criteria do not turn on any disputed factual question. 51 Fed. Reg. at 22,205. In short, the Commission held that Section 7(b) permits it to authorize abandonments by administrative rule, without case-by-case adjudication. 51 Fed. Reg. at 46,787.

Finally, the Commission rejected suggestions that it should undertake to resolve the issue of take-or-pay provisions in natural gas contracts at the same time that it addressed old gas pricing.[8] Although it acknowledged that certain take-or-pay contracts are a problem for the industry, the Commission noted that it was already addressing the take-or-pay issue in its Order 436 proceedings. 51 Fed. Reg. at 22,174-175, 46,783-784. The Commission also noted that, by permitting increased ceiling prices for old gas, Order 451 would allow pipelines to offer higher prices for old gas in exchange for producers' agreeing to renegotiate take-or-pay obligations, thereby facilitating settlement of take-or-pay disputes. 51 Fed. Reg. at 22,195-197. In short, the Commission rejected the suggestion that the take-or-pay problem was so intertwined

[8] Since the 1950s, many pipelines entered into long-term contracts requiring them to take a specified volume of gas or, in the event the gas was not taken, to pay for the specified volume. See, *e.g.*, Pierce, *supra*, at 15. Contracts which include such provisions are commonly referred to as "take-or-pay" contracts.

with vintage pricing of old gas as to require the Commission to provide a comprehensive solution to the take-or-pay issue in this proceeding. 51 Fed. Reg. at 46,783.

Order 451 went into effect on July 30, 1986. An informal survey of petitioners reveals that, during the intervening three and one-half years, at least 3,000 natural gas contracts have been renegotiated or terminated as a direct result of Order 451. The total volumes affected by those contracts comprise some 6.85 trillion cubic feet of natural gas, worth approximately $13.7 billion at spot market prices as of year-end 1989. In addition, hundreds of new contracts have been executed with new customers under the authority of Order 451. Those contracts cover approximately 1.6 trillion cubic feet of old gas, worth approximately $3.2 billion at year-end 1989 spot prices. See also *Natural Gas Price Controls: Hearing on H.R. 5195 Before the Subcomm. on Energy and Power of the House Committee on Energy and Commerce*, 101st Cong., 1st Sess. 156 (Apr. 5, 1989) ("*Hearing on H.R. 1595*") (post-hearing questions and answers) (as of year-end 1988, at least 1286 natural gas contracts renegotiated pursuant to Order 451).

5. On September 15, 1989, a divided panel of the court of appeals vacated the Commission's orders. The court did not dispute the findings of the Secretary of Energy and the FERC concerning the benefits that likely would result from the elimination of vintage pricing of old gas. See, *e.g.*, App. 23a. Nor did the court overturn the FERC's conclusion that the new ceiling price applicable to all old gas is "just and reasonable" within the meaning of the NGA. Indeed, the majority agreed that the end result of the Commission's action was "arguably meritorious." App. 25a. The majority nonetheless held that the Commission had exceeded its statutory authority or acted arbitrarily and capriciously in three respects relevant here.

First, the majority held that Congress had not intended to give the Commission authority in Sections 104(b)(2) and 106(c) to set a single ceiling price for all old gas. App. 23a-24a. According to the majority, vintage pricing of old gas is too "significant [a] feature of the NGPA" to be "jettison[ed]" by the Commission. App. 25a. The panel relied for this conclusion upon its own view of the "congressional compromise" leading to the enactment of the NGPA. That view, in turn, was derived from isolated statements by individual legislators during debates over the NGPA, none of which addressed the Commission's authority under Sections 104(b)(2) and 106(c). See App. 19a-24a. The majority's opinion did not address the statutory language expressly authorizing an increase in the price ceilings, and did not consider whether any deference should be paid to the Commission's interpretation of its own organic statute.

Second, the majority also held that the Commission lacked authority under Section 7(b) of the NGA to "provid[e] for an across the board, preauthorized abandonment provision" (App. 29a), even where the Commission had determined that abandonments pursuant to the GFN procedure satisfied the public convenience and necessity requirements of the NGA. In so doing, the majority nonetheless acknowledged (App. 27a) the contrary holding of the District of Columbia Circuit in *Associated Gas Distributors* v. *FERC*, 824 F.2d 981 (D.C. Cir. 1987), *cert. denied*, 485 U.S. 1006 (1988), which found "'no procedural objection to the Commission's identification of circumstances, in an otherwise valid rulemaking, which automatically trigger its approval of abandonment.'" *Id.* at 1015-16 & n. 17. Furthermore, relying upon *United Gas Pipe Line Co.* v. *McCombs*, 442 U.S. 529 (1979), the majority held that abandonment pursuant to the GFN procedure violated Section 7(b) of the NGA because, in its view, that procedure gives the producer too much con-

trol over the abandonment decision. App. 28a-29a. In reaching this conclusion, the majority again did not address whether the Commission was entitled to any deference in its interpretation of Section 7(b).

Third, the majority held that the Commission had improperly declined to resolve the take-or-pay issue in this proceeding. App. 29a. Although it implicitly recognized that the Commission was already addressing the take-or-pay issue on remand from the D.C. Circuit's decision in *Associated Gas Distributors, supra*, the majority held that the Commission's decision not to resolve that issue in Order 451 was a "regrettable and unwarranted" refusal to deal with a crucial problem that "cannot and will not be wished away." App. 32a (citations omitted). The majority also rejected the Commission's finding that the GFN procedure to some extent would ease the take-or-pay problem because, in the majority's view, that procedure was too "one-sided." *Id.* Accordingly, the majority concluded that the "Commission's inaction on the take or pay problem is based on a rationale which is arbitrary and unsupportable." App. 33a. The majority, however, did not address the question whether the old gas pricing and take-or-pay problems were so closely related that it was unreasonable for the Commission to address the former without fully resolving the latter.

Judge Brown dissented from each of these holdings. He observed that the fundamental flaw in the majority's entire analysis was its decision to "[s]ubstitute[] its own judgment for that of the Commission on what Congress has ordained the Commission may do about the grave problems of the natural gas business." App. 37a. As to the Commission's authority to set a single ceiling price for all old gas under Sections 104(b)(2) and 106(c), Judge Brown observed that "Congress could not have been more explicit in authorizing the Commission to raise statutory ceiling prices . . . for vintage gas sales." App.

46a. As to the Commission's authority to grant abandonment on a generic basis under Section 7(b) of the NGA, Judge Brown pointed out that Section 7(b) "does not require that the Commission act on such matters only case-by-case," and he agreed with the D.C. Circuit's view in *Associated Gas Distributors* that "the law has long recognized that the Commission may act generically when the situation warrants." App. 52a. Finally, Judge Brown observed that "the take-or-pay issue is a discrete matter" that is already being addressed in other proceedings. App. 56a. He therefore decried the majority's "startling" presumption in directing the Commission, in this proceeding, "to consider, and once and for all to *solve*, a matter so perplexing and complex as the issue of take-or-pay contracts." App. 55a (emphasis in original).

The court of appeals denied rehearing on December 15, 1989. App. 58a. Justice White issued a temporary stay on January 10, 1990 (App. 59a), and this Court issued a stay pending certiorari on January 16, 1990 (App. 60a).

REASONS FOR GRANTING THE PETITION

This case presents three important questions concerning the scope of a court of appeals' reviewing authority over a regulatory program created by a federal agency to respond to the problems of an industry over which Congress has granted the agency regulatory jurisdiction. The first is whether the court of appeals has authority to set aside, solely on the basis of isolated and inconclusive floor statements in the legislative history, an agency's interpretation of one of its own organic statutes—in this case the FERC's interpretation of Sections 104(b)(2) and 106(c) of the NGPA—where the agency's interpretation is directly supported by the plain statutory language. The second issue is whether the court of appeals has authority to compel an agency to implement its statutory mandate—the Commission's authority under Section 7(b) of the NGA—on a case-by-case rather than a generic basis, when the agency has reasonably interpreted the

relevant statute to permit generic action. The third issue is whether the court of appeals has authority to require an agency to solve one difficult regulatory issue—the "take-or-pay" issue—as a precondition to the agency's efforts to deal with a different regulatory problem—old gas pricing—without any finding that the two issues are so intertwined as to make it arbitrary for the agency to resolve one without resolving the other.

The majority below has decided each of these important and recurring issues in a way that fails to give any deference to—and indeed undermines—the regulatory authority of the agency charged by Congress with overseeing natural gas policy. See, *e.g.*, App. 36a-37a (Brown, J., dissenting). In so doing, the majority has placed itself in conflict with leading decisions of this Court and of the District of Columbia Circuit. Its resolution of the first issue, for example, conflicts in principle with this Court's decisions in *Chevron U.S.A.* v. *NRDC*, 467 U.S. 837 (1984), and *K Mart Corp.* v. *Cartier*, 486 U.S. 281 (1988), as well as the D.C. Circuit's decision in *National Recycling Coalition* v. *Reilly*, 884 F.2d 1431 (D.C. Cir. 1989), among others. The Fifth Circuit's resolution of the second issue not only conflicts in principle with *Chevron* and *K Mart*, but also squarely conflicts with the D.C. Circuit's decisions in *Associated Gas Distributors* v. *FERC*, 824 F.2d 981 (D.C. Cir. 1987), and *Kansas Power & Light Co.* v. *FERC*, 851 F.2d 1479 (D.C. Cir. 1988). And the court of appeals' resolution of the third issue conflicts with the D.C. Circuit's decisions in *Wisconsin Gas Co.* v. *FERC*, 770 F.2d 1144 (D.C. Cir. 1985), *cert. denied*, 476 U.S 1114 (1986), and *Neighborhood TV Co.* v. *FCC*, 742 F.2d 629 (D.C. Cir. 1984).

If left in place, moreover, the majority's decision to vacate Order 451 will have an enormous adverse impact on national energy policy, on the entire natural gas industry and on consumers of natural gas. It will cast into

doubt at least 3,000 supply contracts negotiated (or renegotiated) during the past three and one-half years under the auspices of that Order. It will seriously stall and, in some cases, prevent the correction of the market distortions that made Order 451 essential. In addition, it will impede the orderly transition to natural gas decontrol that Congress recently mandated in the Natural Gas Wellhead Decontrol Act of 1989, Pub. L. No. 101-60, 103 Stat. 157.

1. The first issue presented arises from the court of appeals' holding that the Commission lacks authority under Sections 104(b)(2) and 106(c) of the NGPA to set a single ceiling price for all old gas. The majority labelled the FERC's action "de facto deregulation" (App. 19a) and, relying upon a few fragments of legislative history describing the general policies of the NGPA, held that the agency had exceeded its authority under those provisions.[9] In so holding, the majority violated at least three fundamental principles of statutory construction.

First, the majority failed to give effect to the plain language of the statute, which unambiguously authorizes the Commission to increase the ceiling price for "*any natural gas* [governed by Sections 104 and 106] (*or category thereof, as determined by the Commission*)" and permits the Commission to do so "by rule or order." 15 U.S.C. § 3314(b)(2), § 3316(c); see App. 46a (Brown, J., dissenting). The statutory language in no way pre-

[9] On its face, this holding is at odds with this Court's statement in *Public Service Comm'n* v. *Mid-Louisiana Gas Co.*, 463 U.S. at 333, that the NGPA authorizes the Commission to raise ceiling prices "*whenever* traditional NGA principles would dictate a higher price" (emphasis added). The majority did not overturn the FERC's finding (51 Fed. Reg. at 22,185-186, 46,768-769) that the ceiling price it adopted for all categories of old gas satisfies "traditional NGA principles."

cludes the Commission from using this sweeping authority to set a single ceiling price for old gas, thereby eliminating vintage pricing within the category consisting of all old gas. See *supra* 9.[10] As a matter of fact and law, that action did not constitute "de facto deregulation," as the majority asserted. App. 19a.[11] But regardless of how the overall effect of FERC's order is characterized, the precise action taken by the Commission unquestionably falls within the plain language of Sections 104(b)(2) and 106(c). This Court and several courts of appeals have held that, where an agency has simply followed the plain, unambiguous terms of its organic statute, a reviewing court cannot overturn the agency's interpretation. See, *e.g.*, *Chevron*, *supra*, 467 U.S. at 843 (courts must give effect to unambiguously expressed intent of Congress); *Atkins* v. *Rivera*, 477 U.S. 154, 162 (1986) (regulation supported by plain language and thus entitled to controlling "legislative effect") (citation omit-

[10] Nor is there any warrant in the statutory language for the majority's seeming suggestion that Sections 104(b)(2) and 106(c) may be "more appropriately interpreted as special relief measures to be utilized in the event that existing congressional ceiling prices become confiscatory." App. 24a n. 24. The statutory grant of authority to raise the ceiling price on "any natural gas or category thereof," and to do so "by rule or order," precludes any argument that those sections are limited to situations requiring case-by-case "special relief."

[11] The majority's characterization of Order 451 as "de facto deregulation" also apparently rested on the majority's view that, aside from the elimination of vintage pricing of old gas, the new ceiling price chosen by the Commission was higher than then-current spot market prices. See App. 14a & n. 15. But nothing in the NGA or the NGPA requires that ceiling prices be set below existing market prices. Nor do ceiling prices displace lower market prices agreed to by private parties. See 15 U.S.C. § 3311(b)(9). Rather, a ceiling price protects consumers from market prices that exceed the ceiling rate determined to be just and reasonable under traditional NGA standards.

ted). The decision below conflicts in principle with these decisions.

Second, the majority erred in relying upon legislative history to overturn an agency interpretation which is, at a minimum, consistent with the statutory language. The majority's decision therefore contravenes this Court's recent decision in *K Mart*, *supra*, which held that "[i]f the agency regulation is *not in conflict* with the plain language of the statute, a reviewing court *must* give deference to the agency's interpretation. . . ." 486 U.S. at 292 (emphasis added). The holding below also conflicts in principle with at least one recent decision of the D.C. Circuit that has faithfully applied the *K Mart* rule. See *National Recycling Coalition* v. *Reilly*, *supra*, 884 F.2d at 1435.

Third, even accepting the relevance of the legislative history relied upon by the court of appeals, the majority failed to give any deference whatever to an agency interpretation that cannot fairly be characterized as anything less than a reasonable reading of the relevant interpretive materials. As previously noted (*supra* 10-11), the Commission repeatedly and expressly analyzed both the language and the legislative history of the NGPA in determining that Sections 104(b)(2) and 106(c) authorize a single maximum ceiling price for all categories of old gas. Even if the statutory language did not clearly justify the interpretation adopted by the Commission (which it does), the legislative history is, at most, inconclusive on that precise question.[12] The court of appeals' refusal to

[12] All of the legislative history relied upon by the majority consisted of floor statements concerning either the political compromise embodied in the NGPA or the NGPA's general purpose of protecting consumers. See App. 19a-24a. Like Senator Domenici's statement discussed above (*supra* note 7), the other statements relied upon by the majority can at most be read as explanations of why Congress chose the Commission's then-existing ceiling price structure as the starting point for price regulation of gas subject to Sections 104 and 106. None of those statements addressed the

defer to the Commission in such circumstances conflicts with several decisions of this Court and other courts of appeals holding that a reviewing court must defer to an agency's construction of its own organic statute as long as it is reasonable. *Chevron*, *supra* (EPA regulation); *Chemical Mfrs. Ass'n* v. *NRDC*, 470 U.S. 116 (1985) (EPA regulation); *United States* v. *Riverside Bayview Homes, Inc.*, 474 U.S. 121 (1985) (Army Corps of Engineers regulation); *Ayuda, Inc.* v. *Thornburgh*, 880 F.2d 1325 (D.C. Cir. 1989) (INS regulation); *Union Pacific R.R. Co.* v. *ICC*, 867 F.2d 646 (D.C. Cir. 1989) (ICC regulation); *Knapp* v. *Commissioner*, 867 F.2d 749 (2d Cir. 1989) (IRS regulation); *Asociacion de Compositores y Editores de Musica LatinoAmericano* v. *Copyright Royalty Tribunal*, 851 F.2d 39 (2d Cir. 1988) (CRT regulation). The court of appeals' departure from these controlling principles warrants this Court's review.

2. The second issue presented arises from the majority's holding that the Commission lacks authority to allow pre-granted abandonment on a generic basis under Section 7(b) of the NGA, even when the Commission has concluded that abandonment in certain well-defined circumstances will serve the public convenience or necessity. The Commission concluded that Section 7(b) gives it broad authority to specify, in advance, conditions under which abandonment of service under contracts for old gas will be permitted without further Commission action. 51 Fed. Reg. at 22,171-172. But the majority, without any analysis of the statutory language or legislative history, held that the Commission lacks authority to enact

Commission's authority under Sections 104(b)(2) and 106(c). Moreover, the majority's reliance upon Congress's concern for consumer protection overlooks the fact that the statute protected consumers primarily by retaining the "just and reasonable" requirement of the NGA, not by setting in concrete the ceiling price structure that existed in 1978. See *supra* note 11.

"an across the board, pre-authorized abandonment provision." App. 29a.

Because the FERC's interpretation is neither unreasonable nor contradicted by the plain statutory language, the court of appeals' decision conflicts in principle with *Chevron*, *K Mart* and their progeny in other courts of appeals. See *supra* 18-21. Nothing in the language of Section 7(b) precludes the Commission from exercising its authority over abandonments in an "across-the-board" order specifying the conditions in which abandonment will be permitted. Indeed, this Court has held that pre-granted abandonment is authorized under Section 7(b) (see *FPC* v. *Moss*, 424 U.S. 494, 500-03 (1976)), and that the Commission may, as a general matter, implement Section 7 on a generic basis without case-by-case adjudication (*FPC* v. *Texaco, Inc.*, 377 U.S. 33, 40-44 (1964)).[13]

Moreover, as both the majority and dissent recognized (App. 28a, 52a), the majority's decision on this issue conflicts with decisions of the D.C. Circuit specifically holding that the Commission has broad power under Section 7(b) to provide pre-granted abandonment on a generic basis, without case-by-case adjudication. In *Associated Gas Distributors* v. *FERC*, *supra*, the court of appeals upheld, in part, a Commission regulation allowing pipelines, in their discretion, to abandon mandatory service whenever a pipeline's customer chooses to exercise its contract modification rights under that regu-

[13] Nor does anything in the statutory language or elsewhere support the majority's apparent belief that the Commission improperly exercised its abandonment authority in this case because, in the majority's view, producers were given undue control over the abandonment decision. This Court's decision in *United Gas Pipe Line Co.* v. *McCombs*, 442 U.S. 529 (1979), relied upon by the majority as a predicate for invalidating the Commission's allowance of pre-granted abandonment, does not support the majority's position because the Commission in that case had not given *any* approval—pre-granted or otherwise—for the abandonment at issue there. See 442 U.S. at 533-34.

lation. See 824 F.2d at 1013-16. The court concluded that there is "no procedural objection to the Commission's identification of circumstances . . . which automatically trigger its approval of abandonment." *Id.* at 1015 n. 17. The court therefore held that this generic, "pre-granted" abandonment aspect of the regulation was an appropriate exercise of the Commission's authority under Section 7(b). *Id.*; see also *id.* at 1015-16 (same).[14] The D.C. Circuit reached the same conclusion in *Kansas Power & Light Co.* v. *FERC*, *supra*, which upheld the FERC's authority to provide pre-granted "limited term abandonment" under Section 7(b). See 851 F.2d at 1483-86; see also *Wisconsin Gas Co.* v. *FERC*, 770 F.2d 1144, 1166 (D.C. Cir. 1985), *cert. denied*, 476 U.S. 1114 (1986) (Commission has discretion to proceed by rulemaking or adjudication in administering NGA generally). This fundamental conflict between two circuits that review the lion's share of FERC cases poses a significant regulatory problem for the Commission and for the entities it regulates, a problem that can be resolved only by this Court.

3. The third issue presented arises from the court of appeals' holding that the Commission had no authority to attempt to resolve the problems associated with vintage pricing of old gas without also resolving the take-or-pay issue. As previously noted (*supra* 12-13), the Commission fully explained why it did not believe it could properly impose a comprehensive solution to the take-or-pay problem in this proceeding and why, in any event, the GFN procedure created by Order 451 would to some extent alleviate that problem. The majority disagreed, and held that the Commission's reasoning was "arbitrary and unsupportable." App. 33a. In so holding, the court of appeals not only substituted its own judgment for the ex-

[14] The D.C. Circuit also squarely rejected the view (see *supra* note 13) that generic, pre-granted abandonment is impermissible because it allegedly places the abandonment decision in the hands of private parties. See 824 F.2d at 1016.

pert judgment of the Commission as to the likely effect of Order 451, but also ignored the Commission's ongoing efforts to resolve the take-or-pay issue in another proceeding.[15]

Most important, however, the court of appeals applied the wrong legal standard in determining that the take-or-pay problem had to be solved as a precondition to the Commission's efforts to deal with the problem of old gas pricing. The usual standard for determining the lawfulness of agency *action* is, of course, whether the explanation the agency has given for its decision is "reasoned." See, *e.g.*, *Citizens to Preserve Overton Park* v. *Volpe*, 401 U.S. 402, 412-17 (1971). But a more deferential standard generally applies in determining the lawfulness of agency *inaction* because an agency has the widest discretion over the proper ordering of its regulatory priorities. *E.g.*, *Heckler* v. *Chaney*, 470 U.S. 821, 831-32 (1985); *Vermont Yankee Nuclear Power Corp.* v. *NRDC*, 435 U.S. 519, 543-45 (1978).

In accordance with that principle, the D.C. Circuit has consistently held that, regardless of the explanation an agency gives, it may not be *required* to take action on one matter in a proceeding initiated to deal with a different matter unless the court of appeals finds that the two issues are so "inextricably related" that the second issue cannot rationally be resolved without also resolving the first. *E.g.*, *Neighborhood TV Co.* v. *FCC*, *supra*, 742 F.2d at 642 (agency has "discretion to defer resolution of issues raised in a rulemaking so long as the issues decided are not 'inextricably related to the issues de-

[15] As previously noted, the Commission is addressing the take-or-pay issue in its Order 436/500 proceeding. See *American Gas Ass'n* v. *FERC*, 888 F.2d 136 (D.C. Cir. 1989); *Tennessee Gas Pipeline Co.* v. *FERC*, 885 F.2d 937 (D.C. Cir. 1989); App. 56a (Brown, J., dissenting). Obviously, a requirement that the Commission also resolve the take-or-pay issue in this proceeding not only will cause a duplication of effort by the Commission and the parties, but also could lead to directly conflicting decisions by two courts of appeals.

ferred'") (quoting *ITT World Communications* v. *FCC*, 725 F.2d 732, 754 (D.C. Cir. 1984)); see also *Western Union Int'l* v. *FCC*, 673 F.2d 539, 541 (D.C. Cir. 1982). As that circuit has held, "for the reviewing court to maintain its proper function, it cannot require agencies to solve all problems that may be related to a particular decision at the same time." *Wisconsin Gas Co.* v. *FERC*, 770 F.2d at 1159-60 (applying "inextricably related" standard in declining to require FERC to address take-or-pay problem in connection with "minimum bill" problem).[16]

That, however, is exactly what the majority has done in its "audacious" requirement that the Commission solve the take-or-pay problem as a prerequisite to eliminating the distortions created by vintage pricing of old gas. See App. 56a (Brown, J., dissenting). The majority imposed that obligation without any finding that the two issues were so inextricably related as to make it unreasonable to resolve one without the other, and no such finding could be made on the present record. See *id.* (noting that "take-or-pay issue is a discrete matter").[17] The court of

[16] This Court applied the same general principle in *FPC* v. *Sunray DX Oil Co.*, 391 U.S. 9, 49-52 (1968), which affirmed the discretion of the FPC to address take-or-pay issues in pipeline proceedings rather than producer proceedings.

Obviously, the "inextricably related" standard does not preclude a reviewing court from holding that an agency's *explanation* for refusing to deal with the second problem is arbitrary, and remanding for further consideration. But a reviewing court may not *require* the agency to resolve the second issue, as the majority did here, without a finding that the two issues are so inextricably related that they must be dealt with simultaneously.

[17] The closest the majority came to such a finding was its assertion that "the prospect for exacerbating the take or pay problem runs rampant throughout the provisions of Order No. 451." App. 33a. But even if this bald assertion were correct (which it is not, see App. 56a (Brown, J., dissenting)), the fact that a regulatory program designed to resolve one problem might "exacerbate" another problem does not mean that the first problem cannot rationally be resolved without also resolving the second. In applying the "inextricably related" standard, the D.C. Circuit has repeatedly rejected

appeals' decision therefore conflicts with the D.C. Circuit's jurisprudence on this important question of administrative law. If left in place, moreover, the majority's decision creates a risk that the Fifth Circuit will hamstring the Commission and other federal agencies with similarly burdensome preconditions to their efforts to resolve discrete regulatory problems. Only this Court can resolve the circuit conflict and remove the risk of improper interference with regulatory priorities created by the decision below.

4. Aside from the doctrinal importance of the questions presented, an additional reason to grant the petition is the dramatic impact the decision below will have on the entire natural gas market.

First, the court of appeals' decision, if left in place, will cast into doubt at least 3,000 gas supply contracts—and potentially any settlements of which they are a part—that have been negotiated or renegotiated since Order 451 went into effect. Order 451 was a key element in a comprehensive regulatory program designed to reduce or eliminate severe distortions following the partial decontrol mandated by the NGPA. Hundreds of parties, including both pipelines and producers, have utilized that order to reach comprehensive settlements of contract disputes, settlements which overwhelmingly led to lower consumer prices. The DOE's Assistant Secretary for Fossil Energy conservatively estimated that, at year-end 1988, 1,286 contracts had been renegotiated under Order 451, a rate of approximately 400 every six months since Order 451 went into effect. See *Hearing on H.R. 1595* at 156. A more recent informal survey of petitioners, reflecting data through year-end 1989, indicates that at least

the notion that the mere "exacerbation" of a separate regulatory problem is alone sufficient to require an agency to address that problem. See, *e.g.*, *Neighborhood TV Co.*, *supra*, 742 F.2d at 643 (even though FCC licensing of low power TV stations interfered with sheriff's radio communications, agency could defer resolution of that problem to another proceeding).

3,000 contracts have been renegotiated or terminated as a direct result of Order 451, affecting approximately 6.85 trillion cubic feet of gas worth approximately $13.7 billion. See *supra* 13. In short, "three years of 451 renegotiations, revisions and abandonments . . . are now in limbo" as a consequence of the holding below. *Unscrambling the 451 Egg*, Natural Gas Intelligence 2 (Sept. 18, 1989); see also *Court Ruling Could Force Invalidation of Gas Pacts*, The Oil Daily 1 (Sept. 19, 1989).

The decision below also creates a significant risk that much of the approximately 1.6 trillion cubic feet of gas contracted to new customers pursuant to Order 451 (see *supra* 13) will have to be redirected to the original customers, thereby forcing the new customers to seek gas from other sources. See *Hearing on H.R. 1595* at 156-59; *Unscrambling the 451 Egg*, at 3. The net effect of the court's decision, therefore, is to cast a shadow over "major components of the market restructuring" that has occurred as a result of the Commission's orders, thereby leaving "buyers and sellers alike unsure of future production and supply." *Court Leaves Gas Industry Twisting in the Wind*, Natural Gas Intelligence 1 (Sept. 25, 1989).

Second, the panel's decision will stall or prevent the correction of the very market distortions that gave rise to the Commission's orders. As previously noted, the Commission expressly found (and the court of appeals did not dispute) that Order 451 was necessary to induce the production of approximately 11 trillion cubic feet of additional old gas—gas that otherwise would not have been produced under the then-existing regulatory system. That amount of gas is more than 50 percent of the Nation's current annual gas consumption. To be sure, the Natural Gas Wellhead Decontrol Act of 1989 (Pub. L. No. 101-60, 103 Stat. 157) ("Decontrol Act") may facilitate the eventual production of some of that gas by eliminating all NGPA price ceilings on or before January 1, 1993.

But the panel's decision will undoubtedly delay, and in many cases preclude, the recovery and delivery of a substantial portion of that gas. It will therefore delay and significantly reduce the $25 billion in consumer savings that the Commission found would be generated by Order 451.

Third, the Fifth Circuit's decision will impair the implementation of the Decontrol Act. The legislative history of that Act indicates that the Commission's pro-competitive initiatives, including Order 451, were "essential" to many legislators' decisions to complete the decontrol process initiated by the NGPA because they wanted the transition to deregulated pricing to be gradual, not abrupt. H.R. Rep. No. 29, 101st Cong., 1st Sess. 6 (1989), *reprinted in* 1989 U.S. Code Cong. & Admin. News 51, 56; S. Rep. No. 39, 101st Cong., 1st Sess. 5-6 (1989). Many members of Congress therefore strongly urged the Commission and the courts "'to retain and improve this competitive structure in order to maximize the benefits" of the new Act. *Id.*; see also 135 Cong. Rec. H3,661 (daily ed. July 12, 1989). The reasons for this recommendation are obvious: If substantial regulation-induced market distortions are in place when full decontrol becomes effective, decontrol could well produce significant (even if only temporary) dislocation and uncertainty. By removing many of those distortions, Order 451 will facilitate the gradual transition to decontrol mandated by the Decontrol Act. The court of appeals' decision to dismantle Order 451 will impede that transition and undermine Congress's objective.[18]

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[18] In unsuccessfully opposing petitioners' application for a stay, respondents United Distribution Companies, *et al.* argued that the Decontrol Act substantially eliminates any need for review of the decision below. That argument is incorrect for at least three reasons, two of which reflect the fact that Order 451 is the cornerstone of a regulatory system that Congress built upon in enacting the Decontrol Act: *First*, the Decontrol Act cannot avert the severe disruption and uncertainty in natural gas markets that will be created if the Fifth Circuit's decision remains in place. See *supra* 26-28. The Decontrol Act has no effect on the trillions of cubic feet of gas covered by Order 451 that were purchased between July 1986 (when Order 451 became effective) and July 1989 (when the Decontrol Act was enacted). Moreover, substantial quantities of gas for which wellhead price regulation will be eliminated by the Decontrol Act on January 1, 1993, will continue to be subject to Order 451 until that date. *Second*, even beyond 1993, the Decontrol Act will not alleviate distortions in the pricing of gas sold under a large group of contracts covered by Order 451, namely, long-term contracts which allow price changes only by regulatory directive (*e.g.*, certain contracts with "area rate" clauses). *Third*, the broad legal issues presented in this petition—of judicial deference to the Commission's interpretations of its organic statutes, of the Commission's ability to exercise its abandonment authority on a generic basis, and of the Commission's ability to control its regulatory priorities—will not be affected by the Decontrol Act.

* * *

In sum, the court of appeals has gone well beyond merely setting aside a comprehensive and balanced solution to one set of fundamental problems in the regulation of natural gas. It has also adopted an approach to judicial review that fails to give any deference to the FERC's view of its regulatory authority and flatly conflicts with several leading decisions of this Court and of the D.C. Circuit. Given the large number of FERC appeals that are taken to the Fifth Circuit, the approach adopted by the court of appeals will significantly impair future attempts by the FERC to provide solutions to other energy problems. In addition, the court of appeals' decision will adversely affect billions of dollars worth of natural gas, tens of millions of gas consumers, scores of pipelines, producers, and local gas distributors, and Congress's own recent efforts to facilitate an orderly and gradual transition to full wellhead decontrol. Review by this Court is essential to correct both the doctrinal mischief and the economic havoc created by the court of appeals' decision.

CONCLUSION

The petition for a writ of certiorari should be granted.

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APPENDICES

APPENDIX A

UNITED STATES COURT OF APPEALS
FIFTH CIRCUIT

No. 86-4940

MOBIL OIL EXPLORATION AND PRODUCING SOUTHEAST, INC., *et al.*,
Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

Sept. 15, 1989

Dissenting Opinion Sept. 26, 1989

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Petitions for Review of Orders of the Federal Energy Regulatory Commission.

Before CLARK, Chief Judge, BROWN and JOHNSON, Circuit Judges.

JOHNSON, Circuit Judge: *

Petitioners, joint opponents of the Federal Energy Regulatory Commission's Order Nos. 451 and 451-A, seek review by this Court contending that the Commission exceeded the scope of its authority in promulgating those Orders. For the reasons cited herein, we agree and vacate the orders complained of.

I. AN HISTORICAL PERSPECTIVE

The instant controversy finds its genesis in the enactment of the Natural Gas Act of 1988 (NGA),[1] which was Congress' first attempt to provide a workable system of natural gas regulation. Congress, aware of the regula-

* Judge Brown reserves the right to file a further concurring or dissenting opinion pursuant to Court Policy 15(J).

[1] Pub. L. No. 75-688, 52 Stat. 821 (codified in 15 U.S.C. §§ 717-717w (1976)).

tory gas precipitated by a lack of state power to control interstate pipelines, undertook efforts to bridge that gap through the enactment of the NGA. The regulatory policies of the NGA, which were basically designed to deal with what was considered the burgeoning monopoly power of the pipelines,[2] had significant effects on the future regulation of the nation's natural gas industry.

The provisions of the NGA called for cost based price ceilings for the "sale in interstate commerce of natural gas for resale."[3] Section 4(a) of the NGA[4] provided that the standard for first sale natural gas pricing would be a "just and reasonable" rate calculated in accordance with traditional public utility method principles. The public utility pricing methodology, which allowed pipelines to recover only their actual costs plus a reasonable rate of return and depreciation, was a consumer oriented approach designed to preclude the possibility of pipeline windfalls. In essence, Congress had, through the pricing provisions of the NGA, chosen consumer protection as the overriding objective in the implementation of the nation's first natural gas regulatory scheme. *See, e.g., FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 610, 64 S.Ct. 281, 291, 88 L.Ed. 333 (1944) ("The primary aim of [the NGA] was to protect consumers against exploitation at the hands of natural gas companies").

The Federal Power Commission (the "Commission")[5] was authorized to administer the NGA's provisions. While

[2] For a series of Federal Trade Commission Reports documenting the alleged abuses by natural gas companies, including monopoly control over consumer prices, *see* Federal Trade Comm'n, Utility Corporations, S. Doc. No. 92, 70th Cong., 1st Sess. *See also* S. Res. 83, 70th Cong., 1st Sess., 69 Cong. Rec. 3054.

[3] NGA § 1(b), 15 U.S.C. § 717(b) (1976).

[4] 15 U.S.C. § 717(a) (1976).

[5] Throughout this opinion, the term "Commission" will refer to the Federal Power Commission and its successor, the Federal Energy Regulatory Commission.

the Commission initially construed the provisions of the NGA to regulate gas sales at the downstream end of interstate pipelines,[6] the Supreme Court, in *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672, 74 S.Ct. 794, 98 L.Ed. 1035 (1954), directed the Commission to regulate pricing upstream at the wellhead. In so doing, the Supreme Court interpreted the NGA as "[giving] the Commission jurisdiction over the rates of *all* wholesales of natural gas in interstate commerce, whether by a pipeline company or not and whether occurring before, during, or after transmission by an interstate pipeline company." *Id.* at 682, 74 S.Ct. at 799 (footnote omitted) (emphasis supplied).

Responding to the Supreme Court's directive in *Phillips*, the Commission began regulating rates for individual producers in accordance with the NGA's just and reasonable standards through the application of traditional public utility rate setting principles. Because the Commission initially undertook this task by calculating producer rates on an individualized basis, the Commis-

[6] The Supreme Court, in *Public Service Comm'n of New York v. Mid-Louisiana Gas Co.*, 463 U.S. 319, 103 S.Ct. 3024, 77 L.Ed.2d 668 (1983), explained that the NGA

> authorized rates that were "just and reasonable" within the meaning of [the NGA] by examining whatever costs the pipeline had incurred in acquiring and transporting the gas to the consumer. If the pipeline itself or a pipeline affiliate had produced the gas, the actual expenses historically associated with production and gathering were included in the rate base to the extent proper and reasonable. However, if the pipeline had purchased the gas from an independent producer, *the Commission did not take jurisdiction over the producer to evaluate the reasonableness of its rates; it only considered the broad issue of whether, from the pipelines' perspective, the purchase price was "collusive or otherwise improperly excessive."*

Id. at 328, 103 S.Ct. at 3030 (citations omitted) (emphasis supplied).

sion soon became unable to keep up with its workload.[7] Accordingly, the Commission shifted from its individualized rate setting scheme to an area rate regulation system whereby producer rates were calculated on the basis of a particular region's average production costs, average investment costs, and average rates of return. *See* Statement of General Policy 61-1, 24 F.P.C. 818 (1960). While the Commission's new regional system preserved the earlier method of calculating prices on the basis of historical costs rather than projected costs, it established a two-tiered rate structure for each area regulated. The area rates, one for "old gas" and one for "new gas" were governed by a Commission set control date. Wells drilled after the control date were priced at a "new gas" rate and wells drilled before the control date were priced at an "old gas" rate. The new pricing system, known as "vintage pricing" or "vintaging"[8] was based on the theoretical assumption that for gas that was already flowing, "price could not serve as an incentive, and since any price above average historical costs, plus an appropriate return, would merely confer windfalls." *Permian Basin Area Rate Cases*, 390 U.S. 747, 797, 88 S.Ct. 1344, 1375, 20 L.Ed.2d 312 (1968). The Supreme Court, in the *Permian Basin Area Rate Cases*, 390 U.S. 747, 88 S.Ct. 1344, 20 L.Ed.2d 312 (1968), affirmed the Commission's

[7] The Commission estimated that it would be unable to finish its 1960 workload until 2043. *See* Statement of General Policy 61-1, 24 F.P.C. 818 (1960).

[8] Under vintaging, natural gas is priced with reference to the date of the sales contract, or as has been the case lately, the date when the gas was first produced. The rate for older vintages is lower than the rate for later vintages. Logically, the difference is explained by the fact that production and development costs were lower when the earlier gas was discovered. The purpose of vintaging is to provide producers with a reasonable, but not excessive return on their sunk investment. *See, e.g.*, Opinion No. 770, "National Rates for Jurisdictional Sales of Natural Gas," 56 F.P.C. 509, 521 (1976).

area rate system concluding that not only did the Commission's new regional system yield reasonable prices, but that the Commission's prior individualized approach had become unworkable. *Id.* at 777, 88 S.Ct. at 1365.

With the implementation of the two-tiered vintage pricing system, the Commission hoped that its higher "new gas" prices would stimulate the development of new gas reserves while at the same time ensuring continued consumer protection through lower "old gas" prices. Significantly, however, the Commission was empowered only to regulate the wellhead price of natural gas to be sold for resale in the *interstate* market. Rates on the *intrastate* market on the other hand remained largely uncontrolled. The result of interstate only regulation was that prices for gas sold on the interstate market were kept relatively low while prices for gas sold on the intrastate market continually rose as demand rose. Natural gas shortages increased as a result of sharp pipeline delivery curtailments on the lower priced interstate market.

In an effort to relieve the disturbing shortages, the Commission abandoned the area rate pricing system in favor of a national rate pricing approach. *See Southern Louisiana Area Rate Proceeding*, 46 F.P.C. 86, 110-111 (1971); *National Rates for Natural Gas*, 51 F.P.C. 2212 (1974) (Opinion No. 699). The new national rate approach applied to gas produced from all wells that were drilled after January 1, 1973, and applied across the board to independent producers, pipelines and pipeline affiliates. Additionally, the Commission, in order to ameliorate production shortages, abandoned its prior pure historical cost based approach in favor of an incentive price approach in order to stimulate development of new reserves. *National Rates for Natural Gas*, 52 F.P.C. 1604, 1615-18 (1974) (Opinion No. 699-H). Concurrently, the Commission abandoned, at least temporarily, vintage pricing.

Albeit well intentioned, the Commission's efforts to correct shortages on the interstate natural gas market were inadequate. Recognizing the need to take action, and after some nineteen months of heated debate between the members of Congress who favored deregulation and those who did not,[9] Congress enacted the Natural Gas Policy Act (NGPA).[10] In the NGPA, Congress gave the Commission power to do what the Commission had been unable to do before—regulate wellhead prices in the intrastate market. As a compromise measure, the NGPA contemplated the eventual deregulation of certain categories of natural gas, provided for the gradual price increase of all categories of natural gas, and authorized Commission regulation of natural gas transportation between interstate and intrastate markets.[11]

The NGPA established a pricing system which was based, in part, on the genre of the gas to be regulated, namely, "old gas," "new gas," and "high cost gas." More specifically, the NGPA set price ceilings on gas depend-

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[9] Attempts by those who favored deregulation to enact laws which effect deregulation were numerous, but unsuccessful. The most serious attempt was made during the 84th Congress when both Houses passed H.R. 6645, which would deregulate wellhead prices. 101 Cong. Rec. 11930 (1955) (House vote); 102 Cong. Rec. 2096 (1956) (Senate vote). Then President Eisenhower vetoed the bill on grounds totally unrelated to the merits of deregulation. *See* D. Eisenhower, Pub. Papers 256 (1956).

[10] 92 Stat. 3350, (codified in 15 U.S.C. § 3301 *et seq.* (1982)). *See Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Board of Mississippi*, 474 U.S. 409, 420, 106 S.Ct. 709, 715, 88 L.Ed.2d 732 (1986) (Although in enacting the NGPA, Congress moved towards a less regulated natural gas market, Congress expanded in some respects federal control.)

[11] The NGPA specified the maximum lawful price which could be charged for "first sales" of gas produced in each of eight enumerated categories of gas. The NGPA also prescribed rules for raising prices each month on "first sale" gas and for passing those price increases down to ultimate purchasers.

ing on when or how the gas was produced. Newer, harder to produce gas commanded higher price ceilings while older gas already under production was pegged with lower price ceilings. Congress had, through the pricing provisions of the NGPA, sought to balance the interest of the consumer by keeping old gas prices low while at the same time encouraging the development of new reserves through incentive pricing.[12]

Recognizing that for certain categories of gas, the new NGPA price ceilings might be set too low, Congress provided an escape valve for the Commission. NGPA sections 104, 106 and 109 authorized ~~the~~ Commission to raise prices in accordance with traditional NGA "just and reasonable" principles for three particular categories of gas. Similarly, section 110(a)(2) appeared to give the Commission the authority to raise price ceilings for the other five categories of gas enumerated in the NGPA. Congress, however, declined to give the Commission the authority to mandate lower price ceilings than those provided for by the NGPA.

The effects of the NGPA were bittersweet. Clearly, the NGPA's regulatory scheme ameliorated, if not eliminated, the disparity between the interstate and intrastate natural gas markets which existed prior to the passage of the Act. Also, the increased prices provided by the NGPA stimulated increased production of natural gas by providing producers with the incentive to develop additional natural gas supplies. Accordingly, natural gas shortages were alleviated. On the down side, the NGPA's

[12] This Court has previously recognized this delicate balance of interests struck by Congress. In *Pennzoil Co. v. FERC*, 645 F.2d 360 (5th Cir. 1981), we noted that the NGPA "adopted an incentive-based approach to rate-setting for gas production, providing substantially higher prices for 'new' gas than was currently available. At the same time, the NGPA provided consumer protection by maintaining lower prices on flowing gas, providing only limited future price deregulation in 1985, and extending price controls to intrastate sales of gas." *Id.* at 367 (footnotes omitted).

new pricing system created market distortions because it priced categories of natural gas at various levels. Additionally, during the gas shortages of the 1970s and early 1980s, many pipelines entered into take or pay contracts which commanded high prices for large volumes of gas. Later, after the NGPA's provisions had effectively cured earlier shortages, gas became more plentiful and prices become lower. Producers nevertheless continued seeking higher than market prices for gas covered by earlier executed take or pay contracts. As one consequence of higher prices, pipelines had difficulty selling gas.[13] An oversupply resulted along with inevitable negative economic consequences flowing therefrom. Producers curtailed exploration and development of new reserves. Pipelines were burdened with substantial take or pay obligations. In sum, as a result of all of these circumstances brought on by the implementation of the NGPA, the natural gas markets became fraught with distortions.

In an initial attempt to correct these market distortions, the Commission issued a Notice of Inquiry wherein the Commission proposed to increase old gas prices. Notice of Inquiry, *Impact of the NGPA on Current and Projected Natural Gas Markets*, IV F.E.R.C. Stats. & Regs. ¶ 35,512 at 35,560, 47 Fed.Reg. 19,157 (1982). Specifically, the Commission's attempt in that regard was ultimately abandoned because of congressional opposition. *See* S. Res. 331, 97th Cong., 2d Sess. (1982). Some three years later on November 18, 1985, the Secretary of Energy (the "Secretary"), pursuant to Section 403 of the Department of Energy Organization Act,[14] tendered to the Commission a notice of proposed rulemaking which, in turn, ultimately prompted the Commission's promulgation of Order No. 451. The Secretary, in his proposal, advanced the argument that the Commission's existing

[13] Other factors also contributed to this circumstance. Among them were warmer temperatures and an economic recession.

[14] 42 U.S.C. § 7173 *et seq.*

pricing scheme for old gas inhibited the production of vast reserves of old gas, encouraged the importation of oil and gas, and promoted higher prices to consumers. Significantly, the Secretary admitted that while legislative decontrol of gas prices would be the optimal solution for the problems caused by the old gas pricing structure, until such time as Congress did institute deregulation of old gas, the initiatives which eventually were embodied in Order No. 451 would provide an interim solution.

After notice and comment rulemaking and a two day public conference, the Commission issued Order No. 451 on June 6, 1986. The Commission, in Order No. 451, had adopted the Secretary's proposal with some modifications. In Order No. 451, the Commission collapsed the vintaging system which had prevailed under the NGPA and applied a replacement cost methodology to set an above market, purportedly "just and reasonable" price ceiling applicable to all categories of old gas. Thus, the Commission had essentially achieved de facto deregulation of old gas.[15] First sellers of section 104 and section 106(a) gas were now able to charge up to the maximum lawful price, if the price were allowable under a contract entered into after July 18, 1986. Additionally, the Commission determined in Order No. 451 that the contractual authority for the increased sales prices of section 104 and section 106(a) gas was to be found in indefinite price escalator clauses present in existing contracts. The Commission, while acknowledging that the new price ceiling exceeded

[15] The Commission's new price ceiling greatly exceeded the competitive market price that existed in June 1986, and continues to exceed the competitive market price today. Thus, de facto deregulation of old gas appears to have been the Commission's real goal, and that circumstance is best illustrated by the Commission's decision to base the "old gas" ceiling price on a replacement cost methodology that "[*b*]*est reflect*[*ed*] *the level at which prices would be established if deregulation of old gas were to occur.*" Order No. 451 at 95 (emphasis supplied). Moreover, the Commission concedes that it has never before applied a replacement cost methodology to flowing (old) gas.

existing market prices, contended that market forces would reduce the actual price paid for old gas to levels consistent with the NGA's consumer protection mandate. Further, the Commission concluded that sections 104(b)(2) and 106(c) of the NGPA gave the Commission sweeping authority to raise old gas prices, and that there was no requirement that the Commission find the present gas prices unreasonable before raising them.[16] Nevertheless, in Order No. 451, the Commission specifically found that the existing pricing scheme with respect to old gas was, in fact, unjust and unreasonable because it contributed to serious market distortions and thwarted gas reserve replacement.[17]

[16] Sections 104(b)(2) and 106(c) of the NGPA are virtually identical and provide that

> The Commission may, by rule or order, prescribe a maximum lawful ceiling price, applicable to any first sale of any natural gas (or category thereof, as determined by the Commission) otherwise subject to the preceding provisions of this section, if such price is—
>
> (A) higher than the maximum lawful price which would otherwise be applicable under such provisions; and
>
> (B) just and reasonable within the meaning of the Natural Gas Act.

15 U.S.C. §§ 3314(b)(2); *see also* 3316(c) (1982).

The above mention of the Natural Gas Act's "just and reasonable" language refers to the following provisions contained in section 4(a) of that Act:

> All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is declared to be unlawful.

15 U.S.C. § 717c(a) (1982).

[17] The Commission was driven, in part, by the explicit expectation that the provisions of Order No. 451 would stimulate increased production. In that regard,

In Order No. 451, and its successor, Order No. 451-A,[18] the Commission prohibited the automatic collection of the new higher ceiling price for old gas explicitly acknowledging that the new ceiling would yield unjust and unreasonable prices. Order No. 451-A at 128. To prevent such a result, the Commission provided for a good faith negotiation (GFN) procedure governing price increases.

The GFN process, which can only be initiated by a producer, consists of three steps. Step One allows a producer

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> [T]he Commission found most persuasive studies showing that if current old gas prices were held at their present levels, approximately 11 Tcf of old gas reserves would not be produced. The 11 Tcf of old gas reserves not produced as a result of vintaging would have been replaced by higher-priced energy supplies. In part, these incremental supply requirements would be met by foreign imports of both oil and gas and the nation's energy security would thereby be compromised and its trade balance weakened. Regardless of the source of the incremental supplies, however, the nation's energy users would be required to pay more for these incremental supplies than would be necessary.

Order No. 451-A at 18. Other benefits were also expected by the Commission as a result of Order No. 451:

> Producers with old gas reserves will obtain additional revenue for exploration and development of gas reserves. Customers will benefit from increased competition and may pay lower gas prices, free from regional disparities, as they gain access to alternative sources of supply and transportation through Order Nos. 451 and 436. The competitive pressures of a wide-open market may also benefit pipelines with increased throughput and the settlement of take-or-pay disputes with producers in exchange for the pipelines' agreement to pay higher old gas prices. Producers may also be persuaded to renegotiate high-cost gas contracts as old gas prices rise, in order to take advantage of increased marketing opportunities for their gas.

Shoneman & McConnell, *FERC Order No. 451: Freedom (Almost) for Old Gas*, 7 Energy L.J. 299, 324 (1986).

[18] Order No. 451-A clarified Order No. 451. For a discussion of those clarifications, *see* Mogel and Mann, Natural Gas: Current Federal and State Developments 16-20 (1987).

to request a pipeline to nominate the price at which the pipeline would be willing to continue buying old gas under any existing contract.[19] Step Two requires the pipeline to nominate the maximum price up to the ceiling price it would be willing to pay for the old gas *if it wishes to maintain the contract*. During Step Two, the pipeline also has the prerogative to request the producer to nominate a price at which the producer would be willing to continue sales of *any* gas (old or new) under *any other* existing multi-vintage contracts. Finally in Step Three, the producer has the prerogative to nominate a price for gas covered by the pipeline's Step Two request. During Step Three, the producer then may also request that the pipeline nominate a price for any old gas included in the multi-vintage contracts designated by the pipeline in Step Two.

As seen above, the producer (in Step One) is vested with the unilateral right to initiate the GFN process.[20] In the event that the pipeline (in Step Two) nominates anything less than the new, above market ceiling price for old gas as provided for in Order No. 451, the producer has an additional alternative: the producer has the unilateral right to terminate the existing sales contract,

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[19] Order No. 451 defines an existing contract to include an expired contract by which gas is being sold pursuant to an obligation imposed by a certificate of public convenience and necessity. The GFN procedure does not apply to contracts entered into after July 18, 1986, nor does it apply if, after that date, the parties renegotiate the sale price or any other sale terms of old gas under an existing contract. The Commission, on rehearing, did, however, allow for parties to agree in writing to preserve their rights under the GFN procedure even though an existing contract for old gas was amended after July 18, 1986.

[20] Although Order No. 451 became effective on July 18, 1986, a producer could not request pipeline nominations until November 1, 1986. Subsequently, that date was moved to December 18, 1986. Finally, as a result of the issuance of Order No. 451-A on December 15, 1986, the date was again postponed until 30 days ofter Order No. 451-A was published in the Federal Register.

receive automatic abandonment of the underlying sales obligation, and require the contracting non-open access pipeline to transport the released gas to new purchasers. To exercise its unilateral right to terminate the contract accordingly, the producer must provide the former pipeline purchaser with thirty days notice of contract termination, and must comply with certain requirements governing the subsequent sale of the released gas. In Step Three, if the producer does not nominate a price covered by the pipeline's Step Two request, the pipeline may terminate its purchases of all or part of the gas named in the request.

The joint opponents, petitioners herein, challenged the provisions of Order No. 451 through rulemaking comments and rehearing requests. The petitioners contended that the Commission did not have authority to adopt the Secretary's proposal because it 1) effectively deregulated old gas and eliminated vintaging contrary to congressional intent; and 2) used replacement costs as the starting point for the calculation of the new price ceilings on the old gas. The petitioners additionally asserted that current market conditions, specifically the surplus of natural gas, did not justify the need for such severe measures. Additionally, the petitioners objected to the Commission's failure to effectively address the problem of high cost take or pay contracts in its promulgation of Order No. 451. The petitioners complained that unless the Commission made the problem "take or pay" contracts market responsive, a tremendous increase in the old gas price ceiling would exacerbate the already serious problem and would ultimately result in higher consumer prices. Finally, the petitioners assert that the Commission's desire to protect against premature abandonment of certain old gas production and stimulate additional production from certain flowing gas reserves could be

achieved through alternative measures and in a far less costly manner.[21]

The Commission rejected the contentions of the petitioners and, on December 15, 1986, the Commission, by a unanimous vote, issued Order No. 451-A denying petitions for rehearing of Order No. 451. Thereafter, petitioners filed for review by this Court of the Commission's Order Nos. 451 and 451-A.

II. DISCUSSION

The petitioners object to the pricing, abandonment, take or pay and transportation components of Order Nos. 451 and 451-A. We will address each objection in turn.

A. *Pricing*

Perhaps the most salient and controversial provision of Order No. 451 is the Commission's new pricing structure for old gas. In establishing this new pricing structure, which, as mentioned previously, collapses the previous vintage system and sets a single higher than market ceiling price on old gas, the Commission relies on the "just and reasonable" standard articulated in sections 104(b)(2) and 106(c) of the NGPA. The petitioners strenuously argue that the Commission's reliance on sections 104(b)(2) and 106(c) as justification for raising ceiling prices on old gas is misplaced, and assert that the Commission has ignored congressional intent and exceeded its authority by allowing for de facto regulation of old gas. We are constrained to agree.

An examination of the legislative history of the NGPA reveals that its passage was the result of some nineteen months of heated Capitol Hill debates on the issue of whether the natural gas industry should be de-

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[21] For example, the petitioners contend that the Commission could have targeted specific old gas reserves rather than raising old gas price ceilings across the board.

regulated.[22] As discussed above, the NGPA was Congress' response to natural gas shortages precipitated by

[22] The following are excerpts from the Congressional record which demonstrate the challenges faced by Congress in resolving the differences of its members concerning decontrol of the natural gas industry and the complex problems involved in resolving the deficiencies of the NGA's regulatory devices.

124 Cong.Rec. S15019-20 (daily ed. Sept. 13, 1978) (remarks of Senator McIntyre).

> Mr. President, it is time to resolve the conflict over natural gas pricing policy. . . . During the debate nearly a year ago, I was against the proposal to decontrol the price of natural gas. Instead, I favored a policy that would have provided incentives to the natural gas industry to bring in more gas, yet at the same time protect consumers from unwarranted increases and the inflationary effects of sudden price increases.
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> * * * *
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> Clearly, we need a compromise between these two extremes. Clearly, we must establish a Federal policy that protects consumers and at the same time provides assurances and incentives to gas producers. Congress as a whole and the energy conferees have labored for nearly 17 long months to come up with a bill that provides this policy. They have put their collective wisdom into the compromise bill that is now before us.
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> * * * *
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> It is apparent to all of us that the compromise is not perfect. Some of its flaws are obvious. For example, both the Senate and House passed so-called incremental pricing provisions to protect residential consumers of gas from being hit with the biggest increases. Somehow, the compromise ended up with an incremental pricing provision that protects residential consumers less than either the Senate or House bill.
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> * * * *
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> And if we defeat this compromise, what policy will we put in its place for the long run? Are we to cave in to full decontrol, which would create about as much new supply as this bill, but at substantially higher cost? That is what the gas lobby is hoping for. That is why they are prowling the halls of Congress. And the other opponents of this compromise—the consumers organizations, whom I count as my friends—they want to defeat the compromise in the hope that the Federal bureaucracy will roll back gas prices and will on its own begin regulating the gas that producers are now keeping in their own states.

[Continued]

the Commission's lack of regulatory authority over the intrastate market. The NGPA, as recognized by the Supreme Court in *Public Serv. Comm'n of the State of New*

[22] [Continued]

> But this is Congress' job. The time has come for this body to put aside regional differences and partisan bickering. Both sides of the debate in the Congress have fought hard for what each thought was best. We now have before us a gas bill that gives neither side all that it wants. But this compromise does provide certainty; it does provide a unified Federal policy for the first time. It does provide substantial incentives for the production of more domestic natural gas. And at the same time it provides a measure of protection for consumers from sudden and unwarranted price increases.

124 Cong. Rec. S14869 (daily ed. Sept. 11, 1978) (remarks of Senator Jackson).

> We are proposing a policy which concentrates the rewards of higher prices where they are most needed—on the development of new, high cost gas.
>
> * * * *
>
> We wanted to elicit the maximum supply response at a minimum cost to consumers . . . . [i]t also allowed the conferees to achieve a bill that will encourage production while protecting consumers from applying unnecessarily high prices for gas that they could expect to receive at lower prices under current policies.

124 Cong. Rec. H13242 (daily ed. Oct. 14, 1978) (remarks of Rep. Sharp).

> What we are proposing to do and asking Members to act upon is not a perfect solution.
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> * * * *
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> Mr. Speaker, we put the highest incentive where the highest risks are and where the greatest gains might come from. The next highest incentives are where there are new gas supplies and major risks, but we think there are pretty good chances that gas can be found.
>
> We tried to see to it that we were protecting the consumers from paying the highest prices where it was not deserved. We tried to focus those prices incentives where they would do the most good.

For additional discussion of the legislative history behind the NGPA, *see* Note, Legislative History of the Natural Gas Policy Act, 59 Texas L.Rev. 101 (1980).

York v. Mid-Louisiana Gas Co., 463 U.S. at 331, 103 S.Ct. at 3031, was the result of congressional compromise of two "strong, but divergent" postitions with regard to the optimal strategy for stimulating increased production of natural gas without higher consumer prices. As we have previously recognized, the essence of the NGPA compromise was the adoption of "an incentive-based approach to rate-setting for gas production, providing substantially higher prices for 'new' gas than was currently available [while ensuring] consumer protection [through] lower prices on flowing gas, providing only limited future price deregulation in 1985, and extending price controls to intrastate sales of gas." *Pennzoil v. FERC*, 645 F.2d 360, 367 (5th Cir.1981) (footnotes omitted).

In that regard, we are persuaded that Congress deliberately chose to maintain lower old gas prices in order to "[concentrate] the rewards of higher prices where they are most needed—on the development of new, high cost gas" and to elicit "[t]he maximum supply response at a minimum cost to consumers." 124 Cong. Rec. S.14869 (daily ed. Sept. 11, 1978) (Remarks of Sen. Jackson). Further, remarks made by legislators during the NGPA debates support the conclusion that Congress did not intend for the Commission to abrogate, as Order No. 451 has done, the NGPA prescribed pricing structure. *See, e.g.*, 124 Cong. Rec. 28,884 (1978) (Remarks of Sen. Hart: "[C]onsumers should be protected by regulations which prevent the price of old, inexpensive gas from rising"); 124 Cong. Rec. 28,865 (1978) (Remarks of Sen. Domenici: Elimination of vintaging and deregulation of old gas "not doable" or "ever suggested").

While we do not suggest that the Commission's contentions that the disorder in the natural gas market has resulted, at least in part, from the NGPA's vintage pricing structure which compelled natural gas producers to sell gas at below replacement costs are misguided, we nevertheless are constrained to recognize what we perceive to be a clear congressional intent to preserve the old gas pricing provisions of the NGPA. The Commission contends that in promulgating Order No. 451, it has preserved the intent of Congress to protect consumers from higher prices. The Commission argues that, even though it has raised the price ceiling for old gas greatly in excess of current competitive market levels, market forces will nevertheless eventually act to hold old gas prices down. Further, the Commission reasoned that Order No. 451 would cause more old gas to be brought into the market place and that the increased volume of old gas in the market would bring pressure upon the existing sales of high priced new gas and that, as a competitive matter, new gas prices (or quantity of sales) would be reduced. Consequently, according to the Commission, these circumstances would more than offset the increased prices charged for old gas under Order No. 451's new high ceiling.

The Commission, in glossing over the mandates of the old gas pricing provisions of the NGPA, has attempted to rely on a somewhat ingenious application of the plain meaning rule [23] of statutory construction to implement its own scheme through an expansive reading of its authority under NGPA sections 104(b)(2) and 106(c). On rehearing, the Commission's own words betray its logic:

> [T]he Commission recognizes that section 104(b)(1) of the NGPA was intended to directly incorporate the just and reasonable rates, and thus the cost-based prices according to vintage, in effect at the time of the NGPA's enactment. Further, the Commission agrees that Congress considered this provision for old gas prices to be a significant feature of the NGPA's design, intended to mitigate the effects on consumers

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[23] *See, e.g., FERC v. Martin Exploration Management Co.*, 486 U.S. 204, 108 S.Ct. 1765, 1768, 100 L.Ed.2d 238 (1988) ("The plain meaning of the statute decides the issue presented.") (citation omitted).

of allowing higher prices for new gas. . . . However, . . . the Commission [has not] found any legislative history whatsoever on section 104(b)(2), or the virtually identical section 106(c) and 109(b)(2), that raises any doubt about its plain meaning. If Congress had intended old gas prices to be forever subject to the ceilings in effect when the NGPA was enacted, . . . sections 104(b)(2) and 106(c) would not have been included in the NGPA.

Order No. 451-A at 11-12 (footnote omitted). As we view the above language, Congress' intent was, as it has been in the past, to protect the interests of the consumer through the incorporation of a vintaged old gas pricing scheme *"as a significant feature of the NGPA's design." Id.* (emphasis supplied).

We agrée with the Commission that Congress did not intend, through enactment of the NGPA, to "render the Commission impotent in effectuating its statutory responsibility to serve the public interest." Respondent's Brief at 33. We are also compelled to observe, however, that Congress likewise did not intend, through enactment of the NGPA, to render the Commission omnipotent. Although sections 104(b)(2) and 106(c) do vest the Commission with the authority to raise the NGPA's ceiling prices in accordance with the "just and reasonable" standards of the NGA, this authority does not translate into unfettered discretion.[24] For the Commission to jettison a "significant feature of the NGPA's design" by abrogating the vintage pricing structure, represents, in our view, an improper exercise by the Commission of its limited authority to raise ceiling prices under NGPA sections 104(b)(2) and 106(c). As such, it is an untenable, albeit arguably meritorious,[25] solution to the problem of market distortion in the natural gas industry. More simply put, the Commission has exceeded the scope of its authority under the NGPA.[26]

[24] The Commission, in construing §§ 104(b)(2) and 106(c) to authorize the implementation of a new, higher than market ceiling price for old gas and the elimination of the old gas vintaging system, breaks virgin ground. The Commission has previously construed §§ 104(b)(2) and 106(c) far differently and much more narrowly than it does now. Its prior interpretation of §§ 104(b)(2) and 106(c) was to the effect that those provisions are more appropriately interpreted as special relief measures to be utilized in the event that existing congressional ceiling prices become confiscatory. *See, e.g.,* Order No. 72, "Final Regulations Implementing Section 109 of the Natural Gas Policy Act of 1978," F.E.R.C. Stats. & Reg. (CCH) ¶ 30,135 at 30,965 (1980). Moreover, this Court in *Pennzoil Co. v. FERC,* 645 F.2d 360 (5th Cir. 1981), emphasized that FERC has a "narrow[] authority to administer the NGPA and to prescribe higher price ceilings only in certain circumstances." *Id.* at 379 (emphasis omitted) (citations omitted).

We also note that if this Court were to uphold the Commission's new ceiling price on old gas, the issue could never be revisited except by congressional action. The NGPA does not allow the Commission to lower natural gas ceiling prices.

[25] In *Mid-Louisiana Gas Co. v. FERC,* 664 F.2d 530 (5th Cir. 1981), *vacated on other grounds, Public Serv. Comm'n of the State of New York v. Mid-Louisiana Gas Co.,* 463 U.S. 319, 103 S.Ct. 3024, 77 L.E.2d 668 (1983), this Court remarked that "[t]he Commission's duty is to administer the law Congress passed in light of the purposes for which it was passed. *It is not an agency's prerogative to alter a statutory scheme even if its alteration is as good or better than the congressional one." Id.* at 535 (emphasis supplied). Moreover, the Senate, on Wednesday, June 14, 1989, voted 82-17 in favor of a bill that would lift natural gas price controls on January 1, 1993.

[26] In further support of its contentions, the Commission argues that its new ceiling price is not really an "across the board" increase because the Commission explicitly declined to allow for an *automatic* rate increase. The Commission points to the good faith negotiation process as a fundamental component of Order No. 541 in support of this argument. The GFN process is, however, itself a source of dispute. During oral argument and on brief, the petitioners urged that the GFN process is unacceptably unilateral in nature, and as such, is unreasonable. The petitioners contend that while ostensibly labeled a negotiating device, the GFN process is more of a mechanism by which a producer can unilaterally rewrite

B. *Abandonment*

When Congress enacted the NGPA, it retained, for most "committed or dedicated" natural gas, the abandonment requirements of Section 7(b) of the NGA.[27] Under the Commission's Order No. 451, a producer may, in the event of unsuccessful good faith negotiation, receive automatic abandonment by executing a new sales agreement with a new purchaser and by providing the former pipeline purchaser with at least thirty days notice of contract termination. Thus, the Commission essentially has authorized "pre-granted" abandonment. The controlling regulation, found at 18 C.F.R. § 157.301(b), is captioned "Pre-granted abandonment" and provides that "[a]ny first seller who sells natural gas under the blanket certificate authority of paragraph (a) of this section is authorized to abandon the sale upon termination of the contract under which the sale is made."

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the terms of a sales contract within, of course, prescribed parameters. The petitioners point to the fact that prior to the Commission's issuance of Order No. 451, many parties asked the Commission to allow pipelines as well as producers to initiate the GFN process; the Commission, however, rejected this proposal. Other parties requested authority for greater rights of first refusal for pipeline customers under the GFN process, but the Commission likewise rejected those proposals. In fact, the petitioners contend that every single proposal tendered by the petitioners to make the GFN process a more balanced procedure was denied by the Commission.

[27] Section 7(b) of the NGA reads as follows:

> (b) No natural-gas company shall abandon all or any portion of its facilities subject to the jurisdiction of the Commission, or any service rendered by means of such facilities, without the permission and approval of the Commission first had and obtained, *after due hearing*, and a finding by the Commission that the available supply of natural gas is depleted to the extent that the continuance of service is unwarranted, or that the present or future public convenience or necessity permit such abandonment.

15 U.S.C. § 717f(b) (emphasis supplied).

The petitioners argue that the automatic abandonment procedures promulgated by the Commission amount to a flagrant and unacceptable evasion by the Commission of its regulatory responsibilities under Section 7(b) of the NGA. Further, the petitioners argue that by allowing abandonment determinations to "turn on producer discretion" and by precluding pipeline challenge to producer abandonment and subsequent fact-specific Commission review, the Commission has exceeded its authority under the NGA. The petitioners contend that through the blanket abandonment provisions adopted in Order No. 451, the "Commission withdrew its regulatory presence and allowed abandonment [to turn on] virtually absolute unilateral producer discretion, as guided by economic self-interest." Petitioner's Brief at 41.[28] The Commission, on the other hand, cites *Associated Gas Distributors v. FERC*, 824 F.2d 981 (D.C.Cir.1987), *cert. denied sub nom. Interstate Natural Gas Assoc. v. FERC*, —— U.S. ——, 108 S.Ct. 1468, 99 L.Ed.2d 698 (1988), for the proposition that there is "no procedural objection to the Commission's identification of circumstances, in an otherwise valid rulemaking, which automatically trigger its approval of abandonment. . . ." *Id.* at 1015 n. 17 (citations omitted).

The petitioners point to the "after due hearing" language of section 7(b) as support for their argument that the Commission is obligated by the plain language of the statute to conduct a case specific review regarding abandonment. The Commission on the other hand contends

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[28] In the past, the Commission has stated that "Section 7(b) . . . prohibits abandonments through the unilateral decision of particular producers based upon the economic considerations affecting them." *Arkansas Louisiana Gas Co. v. Amarex Inc.*, Opinion No. 798, 58 F.P.C. 1617, 1635 (1977). Yet, it would appear that the pre-authorized abandonment provisions and the GFN procedures promulgated by the Commission which are at issue here, would, for all practical purposes, do just that. For the first time, the Commission has placed abandonment authority in the hands of private parties.

that pre-granted abandonment in the context of Order No. 451 serves the overall public interest by ensuring that old gas is kept flowing to a willing purchaser. Further, the Commission disputes the petitioners' "after due hearing" argument by citing *Kansas Power & Light Co. v. FERC*, 851 F.2d 1479 (D.C.Cir.1988), for the proposition that, even in abandonment cases, "it is well established that the Commission need not hold an evidentiary hearing when no issue of material fact is in dispute." *Id.* at 1483. The Commission argues that the abandonment provisions of Order No. 451 represent Commission policy that the propriety of abandonment is governed by a balancing of the needs of current gas consumers being served by the gas reserves with the benefits that would be conferred on the natural gas market as a whole if these reserves were released from dedication.[29]

The pre-grant abandonment runs contrary to the instruction of the Supreme Court in *United Gas Pipe Line Co. v. McCombs*, 442 U.S. 529, 99 S.Ct. 2461, 61 L.Ed.2d (1979). In *McCombs*, the Supreme Court reversed a

[29] The Commission first equated the public interest with the interest of the "market as a whole" in an abandonment context in *Felmont Oil Corp. and Essex Offshore, Inc.*, Opinion No. 245, 33 F.E.R.C. (CCH) ¶ 61,333 (1985), *reh'g. denied*, Opinion No. 245-A, 34 F.E.R.C. (CCH) ¶ 61,296 (1986), *rev'd and remanded on other ground sub nom. Consolidated Edison of New York v. FERC*, 823 F.2d 630 (D.C.Cir.1987). As the joint opponents point out, however, the *Felmont* case involved limited term abandonment after a case specific hearing. In *Felmont*, the Commission jettisoned the "comparative needs" test which calls for a comparison of the needs of the existing purchaser of the gas with the needs of the particular purchaser that would obtain the gas in the event of abandonment. In its place the Commission adopted a test which compares the needs of the existing purchaser with the needs of the "market as a whole." Nevertheless, the Commission emphasized that such a shift would not eliminate the need for a factual showing sufficient to justify the proposed abandonment, and that fact-specific consideration of the interests of existing beneficiaries of dedicated service, including mitigation of losses to such beneficiaries, would be preserved.

court of appeals' decision which held that, upon depletion of reserves, a producer may abandon sales without obtaining prior Commission approval. The Supreme Court concluded that such abandonment, without prior Commission approval, would, in effect, allow producers to determine when abandonment would be appropriate. This result, the Court reasoned, was inconsistent with congressional intent. The Commission distinguishes the *McCombs* case by noting that in the instant case, prier abandonment approval has, in fact, been granted by the Commission. We are not persuaded, however, that such a distinction is helpful to the Commission's argument. Rather, it appears that the pre-grant of abandonment contemplated by Order No. 451 would, as in the *McCombs* case, allow a producer, for all practical purposes, to control abandonment through the largely one sided GFN procedure.

In *Public Serv. Comm'n of the State of New York v. FPC*, 511 F.2d 338 (D.C.Cir.1975), the D.C. Circuit emphasized that "[t]here may be reason for the legislature to enact a deregulation for the natural gas industry, but so long as it prescribes a system of regulation by an agency subject to court review the courts may not abandon their responsibility by acquiescing in a charade or a rubber stamping of nonregulation in agency trappings." (citations omitted). *Id.* at 354. Accordingly, we are constrained to conclude that, in the instant case, the Commission has abdicated its responsibility under Section 7(b) of the NGA by providing for an across the board, pre-authorized abandonment provision. Surely such abandonment procedure, being altogether in the producer's control and which may be implemented only at the behest of producer, would be used only when such utilization would serve the producer's economic interest. As the Supreme Court noted in *United Gas Pipeline Corp. v. McCombs*, 442 U.S. 529, 99 S.Ct. 2461, 61 L.Ed.2d 54 (1979), the absence of provisions for factual inquiry into the circumstances for an abandonment allows for the "abandon-

ment determination [to] rest, as a practical matter, in the producer's control, a result clearly at odds with Congress' purpose to regulate the supply and price of natural gas." *Id.* at 539, 99 S.Ct. at 2467 (citations omitted).[30]

C. *Take or Pay*

The take or pay problem was born during the 1970s when critical shortages of natural gas allowed producers to virtually dictate the terms and conditions of contracts for sale of natural gas to pipelines. During those years, the prevailing thought was that natural gas supply shortages would continue for quite some time and pipelines were frequently unable to procure enough gas to meet consumer demand. As a result, pipelines entered into take or pay contracts which typically required the pipeline to take a specified volume of gas from the producer or, in the event the gas was not taken, pay for the specified volume agreed to be taken but not taken. Additionally, take or pay contracts frequently contained automatic price escalation clauses which obligated the pipeline to pay either the highest price allowed by law or the highest price paid in a specific geographic area.

Pipelines today are faced with a market vastly different from the market in the 1970s. Conditions now are such that numerous pipelines simply are unable, in many circumstances, to take the quantity of gas required by existing take or pay contracts. Additionally, the natural

[30] We note that the Commission's reliance on *Felmont Oil Corp.* and *Essex Offshore, Inc., supra,* is misplaced. *Felmont* involved limited term abandonments of shut-in gas. Moreover, *Felmont's* limited term abandonments were granted after a case specific evidentiary hearing. Nor are we persuaded by the Commission's assertions that the right to first refusal granted to a pipeline's firm sales customers protects consumer interests. As the petitioners point out, the Commission, in this assertion, fails to take into account that the right of first refusal has no effect on a pipeline's ability to continue to meet its systemwide obligations to provide adequate supplies of gas at reasonable prices.

gas market of today is characterized by oversupply, substantially lower rates for natural gas, and competition. Accordingly, pipelines with high liability take or pay contracts must pay prices for natural gas that are substantially in excess of current market prices. The end result is that both interstate and intrastate pipelines are currently burdened with take or pay contracts which potentially threaten their very existence as public utilities. At stake may be the spectre of unacceptable rate increases, of unpredictable price movements and even of the unavailability of gas supply.

The petitioners contend that the Commission effectively ignored take or pay issues in Order No. 451 notwithstanding its obligation to resolve the problem. In Order No. 451, the Commission stated that it "believes that the natural forces of competition will resolve the issues surrounding high cost contracts." Order No. 451 at 76. In further deference to forces outside its ambit of control, the Commission, in Order No. 451, reaffirmed its previous position that "problem contracts are primarily a matter for resolution between the parties involved." (footnote omitted).[31] *Id.* Continuing, the Commission emphasized that "[f]or largely *the same reasons expressed in Order Nos. 436 and affirmed in 436-A,* the Commission . . . has confidence that the free operation of market forces will provide a resolution of this issue." *Id.* at 76-77 (footnotes omitted) (emphasis supplied).

In *Associated Gas Distributors v. FERC,* 824 F.2d 981 (D.C.Cir.1987), the D.C. Circuit, vacating Order No. 436, rejected the Commission's adoption of the above rationale because it failed to effectively address the take or pay problem. The Court observed that the rationale

[31] *See* Order No. 436, Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, Docket No. RM85-1-000, 50 Fed.Reg. 42,408, at 42,462-64 (Oct. 18, 1985); Order No. 436-A, 50 Fed.Reg. 52,217 (Dec. 23, 1985), *vacated by Associated Gas Distributors v. FERC,* 824 F.2d 981 (D.C.Cir.1987).

"reflects questionable legal premises" and fails to meet the requirement of 'reasoned decisionmaking.'" *Id.* at 1023. We agree with the D.C. Circuit and conclude that the Commission's continued inaction on the take or pay problem is regrettable and unwarranted. As the D.C. Circuit remarked, the Comission's failure to take action on the take or pay problem "reflects a pervasive frame of mind of the Commission about a crucial problem in the natural gas industry." *Consolidated Edison*, 823 F.2d at 641-42. It simply cannot and "will not be wished away." *Id.* at 639.

The Commission also takes the position that the provisions of Order 451 will serve to facilitate the renegotiation of high cost contracts. In support of that contention, the Commission projects that under Order No. 451, pipelines will be able to offer higher old gas prices in return for reductions in new gas prices, and that contract reformations will thus ensue.[32] We are persuaded, however, by the petitioners' contention that the "producers with the new gas problem contracts and the producers with the old gas contracts differ markedly." Petitioners' Brief at 63 (footnote omitted). More directly, the producers with the least amount of old gas have the largest amount of nonmarket responsive contracts. Additionally, even if a contract provides for the sales of old *and* new gas, the pipeline would probably not get much benefit at the bargaining table since only one-third of all new gas is contained in the multi-vintage contracts that the pipeline can bring to the table.

Most damaging to the Commission's position, however, is the previously discussed one-sided nature of the GFN process. Surely producers would not initiate the GFN process if by doing so, they ran the risk of giving up more on new gas contracts than they would receive in return for their old gas. As we view the operation of

[32] Order No. 451 at 148.

Order No. 451, it would not, as the Commission asserts, alleviate the take or pay problem. Rather, the prospect for exacerbating the take or pay problem runs rampant throughout the provisions of Order No. 451. Accordingly, we conclude that the Commission's inaction on the take or pay problem is based on a rationale which is arbitrary and unsupportable.[33]

D. *Transportation*

We turn now to the last component of Order No. 451 which is challenged by the petitioners—the mandatory transportation of released gas. As mentioned previously, Order No. 451 provides that an existing pipeline purchaser, that is not an open access pipeline,[34] must continue to transport any released gas if 1) the pipeline fails to nominate a price in response to the producer's initial request for such nomination, 2) nominates a price less than the highest price as provided for in the escalation provisions of the sales contract, 3) ceases to purchase gas when the first seller fails to submit a timely price nomination, or 4) ceases to purchase gas after rejecting the price nominated by the first seller. As observed by some commentators, this mandatory transportation provision of Order No. 451 appears, at first glance, to impose a common carrier obligation on pipelines in contravention of the Commission's authority under the NGA. *See e.g.*, Mogel, *Transportation and Marketing of Natural Gas* 175 *et seq.* (1985); *see also* Mogel & Gregg, *Appropriateness of Imposing Common Carrier Status on*

[33] The joint opponents recommended a bilaterally initiated GFN process, expansion of renegotiation rights for problem contracts, and a provision for producer refund of take or pay payments which could no longer be "made up" because of Order No. 451.

[34] On the date this case was orally argued some 19 out of 21 major pipelines were either open access, or had filed for open access status.

Interstate Natural Gas Pipelines, 4 Energy L.J. 155 (1983).

The petitioners likewise adopt the position that the mandatory transportation requirements of Order No. 451 amount to nothing more than the imposition of common carrier obligations on natural gas pipelines, and that such obligations are not permitted under the NGA. In support of this position, the petitioners rely heavily on *Florida Power & Light v. FERC*, 660 F.2d 668 (5th Cir. 1981), *cert. denied*, 459 U.S. 1156, 103 S.Ct. 800, 74 L.Ed.2d 1003 (1982). In *Florida Power & Light*, the Commission ordered Florida Power and Light Company to file a tariff provision which required the Company to provide transportation to a point beyond that which it had agreed on. While *Florida Power & Light* arose under Section 205 and 206 of the Federal Power Act, its holding is nevertheless apposite to the facts in the instant case since NGA sections 4 and 5 were patterned after the Federal Power Act and are virtually identical to Sections 205 and 206 of the Federal Power Act. *See United Gas Pipe Line Co. v. Mobile Gas Service Corp.*, 350 U.S. 332, 346, 76 S.Ct. 373, 381, 100 L.Ed. 373 (1956); *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348, 353, 76 S.Ct. 368, 371, 100 L.Ed. 388 (1956). In reversing the Commission's imposition of common carrier status in *Florida Power & Light*, this Court found that

> [t]he imposition of common carrier status on FP & L, which the orders at issue accomplish, is precisely the authority which the [Federal Power Act] denies the Commission. The legislative history of the [Federal Power Act] makes clear that the Commission lacks the authority to require electric utilities to provide wheeling even on a reasonable request. Accordingly, we conclude that the Commission lacked statutory authority to issue the orders in question.

Florida Power & Light, 660 F.2d at 676 (footnote omitted).

The legislative history of the NGA, when viewed along side its predecessor, the Federal Power Act, leaves little room for doubt that the Commission has exceeded its authority in implementing the transportation requirements of Order No. 451. As the petitioners note, in the first legislation ever undertaken which affected natural gas pipelines, the Interstate Commerce Act of 1906, Congress expressly exempted transporters of natural gas from the definition of common carrier.[35] Later, in 1914, the House rejected a bill which would have imposed common carrier status on the pipelines.[36] Again, in 1935, Congress rejected a bill which would have required pipelines, among others, to transport gas for any person upon reasonable request.[37] As recently as 1978, Congress, in passing the NGPA, specifically precluded the Commission from treating pipelines as common carriers.[38] Even the Commission itself has recognized that the NGA fails to give it the authority to impose common carrier status on pipelines. *See* Order No. 490, "Abandonment of Sales and Purchases of Natural Gas Under Expired, Terminated, or Modified Contracts," III F.E.R.C. Stats. & Regs., Regulations Preambles, (CCH) ¶ 30,797 at 31,036 (1988). ("Pipelines are not common carriers and only have the duty imposed on them by their certificate.") Nevertheless, the Commission here has inexplicably exceeded its authority and essentially made non-open-access pipelines common carriers.

Moreover, the Commission ignored the requirements of the Administrative Procedure Act[39] in promulgating Order No. 451's mandatory transportation requirement.

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[35] Pub.L. No. 59-337, 34 Stat. 584.

[36] S. 3345, 63rd Cong., 2d Sess., 50 Cong.Rec. 5847-49 (1913).

[37] H.R. 5423, 74th Cong., 1st Sess. 303, 304 (1935). *See also* Hearings Before the Committee on Interstate and Foreign Commerce, House of Representatives on H.R. 5423, 74th Cong. 1st Sess. 1646 (1935).

[38] *See* NGPA Section 602(b), 15 U.S.C. § 3432(b).

[39] 5 U.S.C. § 551 *et seq.*

The Commission's notice failed to request comment on its proposed authority, or lack thereof, to impose common carrier status on pipelines. Because the Commission's failure to do so precluded the presentation of relevant evidence essential to reasoned decisionmaking in this case, we must conclude that the Commission has avoided a fundamental responsibility under the Administrative Procedure Act. *See, e.g., Texaco, Inc. v. FPC*, 412 F.2d 740 (3d Cir. 1969). Accordingly, we are constrained to conclude that the Commission has exceeded its authority by imposing common carrier status on non-open-access pipelines through the mandatory transportation requirements of Order No. 451.

II. CONCLUSION

Having relied on the language, purposes and history of natural gas regulation as evidenced by the provisions of the NGA and the NGPA, we are constrained to conclude that the Commission has, in the promulgation of Order Nos. 451 and 451-A, exceeded its authority as conferred by Congress. Further, while we remain poignantly aware that the problems facing the natural gas industry are numerous and complex, we nevertheless emphasize that Congress alone has the power to do—or authorize the Commission to do—what the Commission has done in Order Nos. 451 and 451A. We must therefore vacate Order Nos. 451 and 451-A in their entirety; it is so ordered.

VACATED.

JOHN R. BROWN, Circuit Judge, dissenting.

Because the Court:

¶ *Looks* upon the question of (i) pricing (ii) good faith negotiation (iii) first refusal, (iv) abandonment and (v) mandatory transportation for new customers as separate, individual issues rather than

as integrated parts of a comprehensive solution to the problems of the natural gas business

¶ *Fails* to accord to the Federal Energy Regulatory Commission (FERC) the expertise which Congress invests in it for broad ranging operational fact conclusions and policy including replacement costs in lieu of historical costs of service

¶ *Undertakes* to decide on its own, the factual validity (invalidity) of long range predictions of the Commission

¶ *Overlooks* specific congressional language giving express legislative authority to raise the price of old gas

¶ *Presumes* to impose on the Commission responsibilities to consider and, once and for all, to solve the vexing problem of Take-or-Pay

¶ *Disregards* the practical necessities in the Commission's determination to permit abandonment of existing contracts after good faith negotiation

¶ *Disregards*, likewise, the practical necessities of requiring mandatory transportation by "open access" pipelines of gas for new customers after good faith negotiations and right of first refusal to existing customers and in effect

¶ *Substitutes* its own judgment for that of the Commission on what Congress has ordained the Commission may do about the grave problems of the natural gas business,

I must respectfully dissent.

A Big Single Package

Following the highest political traditions of this nation, in which the people expect of the President and the Executive Department the initiation of programs and

policies affecting matters of great public importance, the action of FERC in the 451 Orders owes much to the Secretary of Energy's December 1985 statement:

> The existing price structure for old gas creates a barrier against the *production of tens of trillions of cubic feet of old gas reserves*, even though these reserves are easier and less expensive to produce than other gas sources. The artificially low prices imposed on old gas by the existing price structure prevents us from producing all our economically recoverable old gas supplies. As a result, Americans are consuming gas from more expensive sources, as well as imported oil and gas, instead of *first consuming inexpensive old gas*. America should produce all its economical gas resources, but it should produce its least expensive gas first. The Department estimates that greater recovery of domestic old gas resources would provide the U.S. economy with *econonomic benefits of over $25 billion during the next decade*. The benefits would result from greater economic efficiency, higher domestic gas production and lower payments for gas and oil imports. (Emphasis added).

This precipitated FERC's initiation of extended proceedings on the problems of the natural gas business including gas surplus and reduced demand, but increasing city/gate prices. The Commission held extended hearings and received written comments from all segments of the gas industry. Thereafter, the Commission, exercising its authority under NGPA §§ 104 and 106 [1] to

[1] Section 104(b)(2):

> Ceiling prices may be increased if just and reasonable. The Commission may, by rule or order, prescribe a maximum lawful ceiling price, applicable to any first sale of any natural gas (or category thereof, as determined by the Commission)

raise ceiling prices "if just and reasonable within the meaning of the Natural Gas Act," issued the two hundred seventy-four page Order No. 451. (R. 5390-5664).

Sharply abbreviated, Order 451:

Allows producers (first sellers) of old gas to engage in Good Faith Negotations (GFN) with pipeline purchasers for a higher price up to the newly created ceilings;

allows sellers to terminate existing contracts in the absence of agreement from GFN;

allows existing sellers to terminate and abandon existing contracts where agreement is reached with a new user/purchaser after notice of first refusal.

The result was to collapse the fifteen different "vintage" price categories under NGPA § 104(a) into a single category with the ceiling price pegged to the highest of the vintage rates. Three reasons were expressed. First, valuable supplies of inexpensive old gas were being inadequately developed. The Commission found that raising the ceiling price would have a significant impact allowing "over 11 Tcf [trillion cubic feet] of additional old gas to be recovered." (R. 5414). Second, the Commission determined that vintage prices kept this old gas priced below a competitive market price. The unequal access to low cost old gas resulted in certain consumers and regions obtaining an unfair competitive advantage.[2]

> otherwise subject to the preceding provisions of this section, if such price is—
>
> (A) higher than the maximum lawful price which would otherwise be applicable under such provisions; and
>
> (B) just and reasonable within the meaning of the Natural Gas Act.

15 U.S.C. § 3314(b)(2) (1982); *see also* 15 U.S.C. § 3316(c) (1982).

[2] The Commission found that:

> wide variations in pipeline access to old gas have created huge disparities in the prices consumers pay for gas at the burner-

Third, in addition to the competitive advantage to some pipelines the rolling-in old gas prices subsidized producers' sales of high-cost gas or price-deregulated gas.

After first determining that since §§ 104(b)(2) and 106(c) expressly authorized the revision of old gas ceiling prices the Commission need not find existing old gas prices unjust and unreasonable in order to change them, the Commission proceeded to find that the existing old gas price structure was unjust and unreasonable because of these distortions and the reserve replacement it engendered. (*See* R. 5460). The Commission then reached this profound conclusion:

> [T]he current problems being experienced in natural gas markets would largely be remedied by collapsing vintages and raising ceiling prices of below-market priced gas.

(R. 5461).

The Replacement Cost Approach

Pursuing its finding that a price increase for "old gas" was necessary, the Commission determined that any ceiling price should, as closely as possible, approximate the replacement cost of that gas.

After explaining that it had previously used replacement costs, *see* Opinion No. 699-H, 52 FPC 1604, 1631 *aff'd, Shell Oil Co. v. FPC*, 520 F.2d 1061, 1076-77 (5th Cir.1975), *cert. denied*, 426 U.S. 941, 96 S.Ct. 2661, 49

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tip around the country. For example, in 1984, the average residential price of gas in Washington, D.C. was $8.05 per Mcf, while the average price in Kansas was $4.49 per Mcf. Kansas is served by KN Energy and Northern Natural, whose old gas "cushions" in 1984 amounted to 65 percent and 47 percent of their wellhead purchases, respectively. On the other hand, Washington, D.C. is served by Transcontinental Gas Pipe Line whose 1984 old gas cushion was only 28 percent of its total purchases.

R. 5414-15.

L.Ed.2d 394 (1976); and *see* Opinion No. 770, 56 FPC 509, 521, *aff'd, American Public Gas Ass'n. v. FPC*, 567 F.2d 1016, 1033 (D.C.Cir.1977), the Commission concluded:

> It seems clear based on the above-cited judicial precedents that the issues of replacement costs versus historical costs as well as vintage-based versus uniform rates are matters within the Commission's reasonably exercised discretion.
>
> * * * *
>
> The NGPA provides strong economic support for pricing old gas at the long-run marginal cost of gas, which is equivalent to replacement cost.

(R. 5485).

Good Faith Negotiations

For natural gas sold under existing contracts having an indefinite price escalator clause, the Commission created a good faith negotiation (GFN) procedure, 18 CFR § 270.201 (1988), under which the producer/seller, to obtain any rate increase, must first request a renegotiation (nomination) of the existing contract price. The purchaser (usually a pipeline) may then accept or reject those terms or proposed alternative prices. The existing purchaser is not obligated to purchase gas it cannot market. If the producer invokes GFN the pipeline/purchaser can require the producer to renegotiate any contracts covering the sale of both vintage (old) gas and high-cost (new or deregulated) gas. *See* 18 CFR § 270.201 (b)(2) (1988). The Commission, in a reasoned way,[3]

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[3] *See* Order No. 451, p. 185:

> . . . the Commission agrees . . . that the good faith negotiation rule . . . could be unbalanced . . . . For example, if a contract included both old and other gas, the producer could seek a higher price for the old gas but the purchaser could not seek a lower price for other gas. If the producer was not satisfied with the price nominated by the purchaser for the old gas, the producer could terminate sales of the old gas to the purchaser,

found that this provision was necessary to balance the operation of GFN and to provide pipelines/purchasers with a means to reduce high-cost gas purchases. The upshot is that if the producer and pipeline/purchaser are unable to agree on new price terms, old gas and mixed contracts can be terminated by either party. On the other hand, if a new price is otherwise mutually agreed upon the sale must continue at the agreed upon price.

Abandonment and Transportation Provisions

As an essential ingredient of the GFN rule, the Commission added two additional provisions to ensure that the old gas continued to reach the market at a fair, negotiated price. First, if a pipeline purchaser fails to respond to the producer's new price nominations and rejects[4] the producer's price to terminate the gas purchase agreement, "[t]he first seller (producer) is authorized, upon 30-days written notice to the existing purchaser, to abandon the sale of the gas" if it has contracted to sell the gas to a new purchaser. 18 CFR §§ 270.201(c)(1), (e)(4) and (f)(5) (1988). Such producer abandon-

> sell that gas to a third party, but require the purchaser to continue purchasing the other gas. . . .
>
> In order to cure these inequities in the operation of the good faith negotiation rule . . . the Commission will modify the [GFN] rule . . . [to] permit the purchaser to seek a lower price for any gas . . . in any contract between the parties which contains some old gas.

(R. 5580-81).

[4] If the producer rejects the nominated price, the producer would be free to sell all the gas to a new purchaser subject to the right of first refusal on the part of the existing firm customers of the existing purchaser. There would be no required term for the new contract, nor any higher price requirement. Once a new purchaser is found, the producer would be released from all obligations in law and contract to the existing purchaser upon 30 days notice. However, in the interim, the producer would be required to continue to sell the gas to the existing purchaser at the existing contract price. R. 5592, Order No. 451.

ment occurs without further Commission action under § 7(b) of the NGA.[5]

The second provision requires that if there is an abandonment of the sale to the pipeline and a sale by the producer of the released gas to others, the pipeline, if not an "open access" pipeline, must continue to transport that gas. 18 CFR § 270.201(a) (1988).

The Commission found:

> We conclude that this rule [GFN] should establish reasonable procedures by which gas is released . . . can be transported by pipelines not under Order No. 436. . . . However, without Commission action, there is no assurance that first sellers will be able to market their released gas unless their existing purchasers have accepted the terms and conditions of Order No. 436. We believe it is essential . . . to assure the availability of transportation service irrespective of whether a particular purchaser has or has not accepted the open-access obligations of Order No. 436 . . .

to formulate reasonable and fair transportation provisions. (R. 5608-09).

Without access to transportation, the GFN process would be insulated from competitive benefits and both producers and pipelines would be restricted in their access to gas supplies released under the rule.

> Under the good faith negotiation procedure, the existing pipeline purchaser may choose or not choose to terminate purchases of gas under an existing contract with a producer. As a condition on the pipeline's exercise of these options, the limited transportation authority is reasonably intended to assure that

[5] If the pipeline is not "open access" such pipeline's firm gas customers "would specifically have a 'right of first refusal'." *See* 18 CFR 270.201(g) (1988).

> the pipeline's existing customers, especially firm sales customers, have a practical means of keeping the gas on-system and getting it transported for their use.
>
> * * * *
>
> In most instances, first sellers would be unable to market released gas to alternative purchasers unless the existing purchaser agreed to transport the gas or is an Order No. 436 transporter. The existing purchaser would have little, if any, incentive to do so, however, because in the absence of transportation the first seller would have little alternative but to continue selling to the existing purchaser at the current price. The result would frustrate the purposes of this rule and force the first seller to accept a price which we have found to deny both consumers and producers the full benefits of competition and long-term reliable gas service under the NGPA and NGA. We therefore believe that [GFN] would be ineffective . . . unless combined with a transportation provision designed to encourage purchasers to negotiate in good faith and to provide first sellers with reasonable access to an alternative market in the event no agreement on pricing is reached.

(R. 5610, 5611-12).

> However, newly priced gas must be keyed to the availability of transportation, or the market-responsive benefit of the rule would be lost, and the public interest benefits of the new ceiling prices also lost. It is in this sense that the new ceiling is only just and reasonable in conjunction with the accompanying transportation provision.

(R. 7428).

The Commission also found that while the price of gas might go up from increased old gas prices it would lower prices and increase supply in the long run.

On rehearing the Commission reaffirmed its finding that producer abandonment was in the overall public interest, (R. 7315), and that over the long haul, customers would have better access to supplies of gas if the old gas could get a willing purchaser. The Commission also reaffirmed its ruling requiring pipelines to continue to provide transportation. (R. 7419).[6]

Pricing

The Court's opinion finds that FERC's abandonment of vintaging and establishing the new ceiling prices for old gas is contrary to both the NGA and the NGPA and beyond the statutory powers of the Commission. Cast in this light, the controversy becomes essentially a rate case "to assure an adequate and reliable supply of gas at reasonable prices." *California v. Southland Royalty Co.*, 436 U.S. 519, 523, 98 S.Ct. 1955, 1957, 56 L.Ed.2d 505 (1977), *citing Sunray Mid-Continent Oil Company v. FPC*, 364 U.S. 137, 147, 151-154, 80 S.Ct. 1392, 1398, 1400-1402, 4 L.Ed.2d 1623 (1960) and *Atlantic Refining Co. v. Public Service Commission of New York*, 360 U.S. 378, 388, 79 S.Ct. 1246, 1253, 3 L.Ed.2d 1312 (1959). Under the just and reasonable standard, § 5, 15 U.S.C. § 717d, the Commission's approval rate must:

> [R]easonably be expected to maintain financial integrity, attract necessary capital, and fairly compensate investors for the risks they have assumed and yet provide appropriate protection to the relevant public interests, both existing and foreseeable.

Permian Basin Area Rate Cases, 390 U.S. 747, 792, 88 S.Ct. 1344, 1373, 20 L.Ed.2d 312 (1968).

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[6] In addition to stressing practical necessities and avoidance of frustration of the objectives of GFN, the Commission stated:

> By requiring a pipeline to continue to provide transportation for released volumes, the pipeline is prevented from unduly discriminating against the existing seller and harming competition by denying a producer transportation and thereby blocking the benefits of the final rule.

R. 7428.

In setting "just and reasonable" rates the Commission is not "bound to the service of any single regulatory formula," *Permian*, 390 U.S. at 776, 777, 88 S.Ct. at 1364, 1365, and so long as the Commission engages in reasoned decision making under the just and reasonable standard ". . . it is the result reached not the method employed which is controlling." *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 602, 64 S.Ct. 281, 287, 88 L.Ed. 333 (1944). All that is needed is a reasoned basis by the Commission "to assure itself that the Commission has given reasoned consideration" to the relevant factors. *Permian Basin Area Rate Cases*, 390 U.S. at 792, 88 S.Ct. at 1373.

After enactment of the NGPA "[t]he aim of federal regulation remains to assure adequate supplies of natural gas at fair prices." *Transcontinental Gas Pipeline Corp. v. State Oil and Gas Board of Mississippi*, 474 U.S. 409, 421, 106 S.Ct. 709, 716, 88 L.Ed.2d 732 (1986).

NGPA Provides Express Authority to Raise Old Gas Ceiling Prices

By §§ 104 and 106 of the NGPA, Congress could not have been more explicit in authorizing the Commission to raise statutory ceiling prices for committed or dedicated gas sales "if such [higher] price is . . . just and reasonable within the meaning of the Natural Gas Act." §§ 104 (b)(2)(B) and 106(c), 15 U.S.C. §§ 3314(b)(2)(B) and 3316(c) (1982), *see* note 1, *supra*. This authority applies to any first sale of *any* natural gas subject to § 104(b)(2), 15 U.S.C. § 3314(b)(2) (1982). This means that Congress granted the Commission the express authority to raise the ceiling prices for vintage gas sales. As the Supreme Court described it, "the statute recognizes that the ceiling may be too *low* and authorizes the Commission to raise it whenever traditional NGA principles would indicate a higher price." *Public Service Comm'n of New York v. Mid-Louisiana Gas Co.*, 463 U.S.

319, 333, 103 S.Ct. 3024, 3032, 77 L.Ed.2d 668 (1983) (emphasis in original).

The sweeping nature of this legislative grant is reflected by expressly allowing this authority to be exercised "by rule or order." Exercise of this power is not confined to case-by-case rate making. It is entirely appropriate for it to be used and employed generically.[7] Nor is there any basis for thinking that Congress intended or demanded that vintage pricing be continued in perpetuity. *Subcommittee on Energy and Power*, 95th Cong., 1st Sess., *Economic Analysis of Natural Gas Policy Alternatives* (Comm. Print 31, 1977) ("Both House and Senate versions would eliminate vintaging of new natural gas.").

Whatever the nuances of expressions by individual members of the Congress in the so-called legislative history, the words of Congress are explicit and decisive. They reflect in no uncertain terms that in enacting the NGA, Congress did not mean to adopt a self-defeating statutory scheme which would bar the Commission from raising vintage ceilings when to do so was part of a comprehensive effort "to afford consumers a complete, permanent and effective bond of protection from excessive rates and charges." *Atlanta Refining Co. v. Public Services Commission of New York (CATCO)*, 360 U.S. 378, 388, 79 S.Ct. 1246, 1253, 3 L.Ed.2d 1312 (1959).

Commission's Determinations Just and Reasonable Under NGA

The Commission meets its just and reasonable NGA responsibilities when it sets rates to assure that there is "an adequate and reliable supply of gas at reasonable

[7] In a related context, *see Texas Eastern Transmission Corp. v. FERC*, 769 F.2d 1053, 1061 (5th Cir. 1985), *cert. denied*, 476 U.S. 1114, 106 S.Ct. 1967, 90 L.Ed.2d 652 (1986), "the drafters' choice of the words 'rule or order' . . . clearly contemplates the establishment of an industry-wide scheme of reimbursement."

prices," *California v. Southland Royalty Company*, 436 U.S. 519, 523, 98 S.Ct. 1955, 1957, 56 L.Ed.2d 505 (1978). The accepted precedents do not require that "just and reasonable" rate making invariably requires rates pegged to recover only historically-based costs.[8] The choice whether to adopt replacement cost pricing "to put some of the burden of replacing scarce gas supplies on the consumers of flowing gas" is the Commission's to make, *Tenneco Oil Co. v. FERC*, 571 F.2d 834, 840 (5th Cir. 1978), *cert. dismissed*, 439 U.S. 801, 99 S.Ct. 43, 58 L.Ed.2d 94 (1978), and this Court has affirmed the Commission's choice to do so. *Shell Oil Co. v. FERC*, 520 F.2d 1061 (5th Cir.1975), *cert. denied*, 426 U.S. 941, 96 S.Ct. 2661, 49 L.Ed.2d 394 (1976).

Without implying, as the Court's opinion suggests, that sustaining Order No 451 would make the Commission *omnipotent* beyond the powers established by Congress, it is clear beyond question that Congress did not by the NGPA intend to render the Commission *impotent* in effectuating its statutory responsibility to serve the public interest. Rather, as the Supreme Court has clearly stated, to achieve the regulatory goal, the Commission must be free "to make the pragmatic adjustments which may be called for by particular circumstances." *Permian Basin*, 390 U.S. at 777, 88 S.Ct. at 1365, *quoting FPC v. Natural Gas Pipeline Co.*, 315 U.S. 575, 586, 62 S.Ct. 736, 743, 86 L.Ed. 1037 (1942).

Replacement cost pricing does not in any way depart from the NGPA's regulatory scheme. The NGPA introduced a regime of market-based wellhead pricing. As the Commission explained in considerable detail, (R. 5433-5437, 5443-5449, 7207-7212, 7324-7333), providing for renegotiation of old gas sales prices capped by a replacement cost ceiling properly carries out the free market

[8] Reliance on *City of Detroit v. FPC*, 230 F.2d 810 (D.C.Cir. 1955) and *Bell Oil Corp. v. FPC*, 255 F.2d 548, 553 (5th Cir.) are misplaced. (See R. 7233-37).

approach reflected in the congressional enactment of the NGPA.

Overall Impact of Commission's Orders Just and Reasonable

The GFN is in no sense an "across-the-board rate increase." Rather, it affords the purchaser the option to pay or not to pay a higher price, to renegotiate some high-cost ("new") gas prices, and to have the opportunity to cancel gas purchase contracts thus paying no increased rates. GFN is a fundamental part of the 451 Orders assuring, in line with the NGPA pricing approach, that prices reflect the market's needs and that the rates are "just and reasonable."

There is no basis for the contention by protestants that increased lower gas prices will result. The Commission's extended explanation, (*see* R. 5529-5568 and 7283-7306), fully supports the Commission's judgmental conclusion that while prices to some consumers might rise in the short term under the new rules, overall and in the long term prices would be lower than otherwise because of the increased supply of relatively lower-priced old gas in the open market competing with the more expensive, incentive-priced and deregulated gas.[9] This is the sort of

[9] The Commission found that:

> under [the] "good faith" negotiation rule, old gas would actually be priced at the prevailing market price or the new ceiling price, so the practical effect of the proposed rule is to provide a price for old gas equal to the market price or replacement cost, *whichever is lower*.

R. 5487.

And, as the Commission expressed on rehearing:

> The Commission continues to believe that eliminating vintaging will cause a substantial increase in recoverable reserves of old gas. Furthermore, nothing raised on rehearing causes the Commission to modify its belief that DOE's study predicting an approximately 11 Tcf increase is the most convincing analysis in the record of that increase.

R. 7262.

expert prediction—"[t]hat 'the increased incentive to compete vigorously in the market would eventually lead to lower prices for all consumers'"—which should be given deference by the courts. *Associated Gas Distributors v. FERC*, 824 F.2d 981, 1008 (D.C.Cir. 1987) (citations omitted).

An essential ingredient in this analysis is that wellhead gas is now practically competitive. The Commission affirms:

> The Commission believes, however, that the market for wellhead natural gas sales is workably competitive. In the first place, Congress so found when it enacted the NGPA. Implicit in the removal of the Commission's authority to regulate the price of new gas is a finding that the wellhead market for natural gas is competitive.

(*See* R. 5532).

As this Court stated in *Pennzoil v. FERC*, 645 F.2d 360, 378-79 (5th Cir. 1981):

> Contrary to the Supreme Court's assumption in *Phillips Petroleum Company v. Wisconsin*, 347 U.S. 672 [74 S.Ct. 794, 98 L.Ed. 1035] (1954), which subjected gas producers to utility-type regulation under the NGA, Congress apparently decided that gas producers do not have "natural" monopoly power.

Similarly, in *Transcontinental Gas Pipeline Corp. v. State Oil and Gas Board of Mississippi*, 474 U.S. 409, 421, 106 S.Ct. 709, 716, 88 L.Ed.2d 732 (1986), the Supreme Court stated, "the NGPA reflects a congressional belief that a new system of natural gas pricing was needed to balance supply and demand . . . [t]he new federal role is to 'oversee a national *market price* regulatory scheme.'" (Emphasis added).

Nor is there any basis for the contention that the Commission "assumed" away the problem of uneconomical

contracts or the existence of a present gas market surplus. The Commission in a reasoned way reached the view that the 451 Orders, by increasing the competition for low-cost gas and by providing pipelines, through the GFN, with the power to require producers seeking higher old gas prices to renegotiate high-cost gas sales in mixed contracts, would blunt the force of uneconomic contracts.

Producer Abandonment and Mandatory Transportation: Proper Exercise of Statutory Authority

This is really at the heart of the goals of Order No. 451. As the Commission explains, Order No. 451 would be a meaningless exercise if, despite the Commission's finding that the vintage pricing system was unjust and unreasonable, pipelines with dominant market power could nevertheless effectively nullify GFN and shut in the gas or otherwise prevent increased supplies from reaching the market at a competitive price.[10]

The GFN does not, as claimed, empower a producer unilaterally to abandon old gas sales. A producer may abandon only if: (1) the GFN process does not work and the pipeline signals its intent not to purchase the gas at a mutually agreed price; *and* (2) the producer has contracted to sell the gas to a new purchaser. 18 CFR §§ 270.201(c)(1); (e)(3) and (4); and (f)(5) (1988).

The rule, circumscribed as it is with protective conditions, reflects the Commission's determination that it is in

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[10] The Commission said:

> As the Commission stated in Order No. 451, abandonment under the good faith negotiation rule is in the public interest, since it is necessary to ensure that the goals of Order No. 451 of increased production of old gas and overall lower prices described . . . are achieved. These goals cannot be achieved unless producers can obtain the market-responsive prices permitted by the rule. Without the possibility of abandonment, purchasers under existing contracts could prevent producers from obtaining those prices by insisting on continuation of the present price.

R. 7315.

the overall public interest that the old gas continue to flow to a willing purchaser. (R. 7314-7320).

Nor, as this Court's opinion asserts, does § 7(b) of the NGA condemn this streamlined abandonment procedure so obviously demanded by practical necessities. The language of § 7(b) does not require that the Commission act on such matters only case-by-case. Nor does any such right arise by implication from the "due hearing" requirement of § 7(b). *See Kansas Power and Light Co. v. FERC*, 851 F.2d 1479 (D.C.Cir. 1988). And, as the D.C. Circuit declared in its monumental *Associated Gas Distributors v. FERC*, 824 F.2d 981, 1015, n. 17 (D.C. Cir. 1987), case, there is "no procedural objection to the Commission's identification of circumstances . . . which automatically trigger its approval of abandonment" since the law has long recognized that the Commission may act generically when the situation warrants. *See, e.g., Permian Basin Area Rate Cases*, 390 U.S. at 774-777, 88 S.Ct. at 1365.[11]

The public interest is clearly served by these hedged-in conditions. First, the Commission found "generally a purchaser's loss of gas under abandonment provisions of the good faith negotiation rule should not cause it, *or the market it serves*, to experience a shortage of supply." (R. 7318). (Emphasis added). With open access pipeline transportation and mandated transportation by non-"open access" pipelines and the right of first refusal accorded the purchaser's firm customers over any released gas, customers are assured access to sufficient supplies at reasonable prices now and into the future. (R. 7318-19).[12] To this is added the significant requirement that

[11] Nor is the Commission's rejection of decisions under the Interstate Commerce Act (ICC) faulty.

[12] In addition, requiring individual producers to file abandonment applications and considering those applications on a case-by-case basis is an inadequate solution. That would cause

abandonment under GFN is permissible only when there is a particular new customer who has contracted to take the gas at a market responsive price which assures that the gas will get to the market.

Mandatory Transportation Lawful

Under the rules established in the 451 Orders, an interstate pipeline not subject to "open access" regulations that stops purchasing the producer's gas "must transport any gas released due to termination or abandonment" under the GFN procedures. 18 CFR § 270.201(h) (1988). To facilitate this change of service—from interstate transportation *and* sale to *transportation* only—the Commission provides a "blanket" certificate. This Court's opinion holds this to be unauthorized as imposing "common carrier" responsibilities on the unwilling or reluctant pipeline. Essentially these same arguments were presented and rejected by the D.C. Circuit in the attack on the Commission's "open access" rules in its celebrated *Associated Gas Distributors* case.[13] After first discussing the pertinence of §§ 5, 7, and 16 of the NGA that Court continued, there is "no language in the NGA barring the Commission from imposing common carrier status on natural gas pipelines, and certainly none barring it from imposing on the pipelines a specific duty that happens to be a typical or even core component of such status." 824 F.2d at 997. That Court found no basis for the attacks

lengthy delays before abandonments could be granted, given the vast number of producers in the nation and the Commission's limited resources. Achievement of the goals of increased production and lower overall prices would thereby be substantially delayed. Thus, granting abandonment in the present proceeding, if the conditions set forth in the Good Faith Negotiation rule are met, is in the interest of the natural gas market as a whole and is necessary to bring about market-responsive prices for old gas and overall lower prices.

R. 7351-52.

[13] 824 F.2d 981 (D.C.Cir. 1987).

on "open access" under either the provisions of the NGA or its legislative history, 824 F.2d at 997-1001, or under either the NGPA, 824 F.2d at 1001-1003, or the Fifth Circuit's decision in *Florida Power and Light v. FERC*, 660 F.2d 668 (5th Cir. 1981).[14] *See* 824 F.2d at 998-99.

Quite apart from the arguments on common carrier status, the Court's opinion errs in disapproving the Commission's order.

First, there seems to be a major misconception. The Commission imposed no new "mandatory" transportation obligation at all. Rather, the Commission required only "a continuation of the pipeline's existing service obligation to move gas to market."[15] Theretofore, the pipeline may have been a *merchant* purchasing gas at the wellhead and a *transporter* carrying the gas to its customers. Now, once GFN procedures have failed to result in agreement upon a new price for old gas under existing contracts, the pipeline becomes a *transporter* moving essentially the *same* gas but now purchased by someone else. The critical fact is that the essential transportation service for the same gas to the interstate market remains exactly the same. (R. 7429-30).

Following traditional lines so stressed by the protestants and this Court's opinion, § 7 of the NGA imposes "a continuing regulatory obligation, irrespective of private contractual arrangements, not to abandon any certificated obligations before obtaining authorization from the Commission to do so." *Panhandle Eastern Pipe Line Co. v. FERC*, 803 F.2d 726, 728 (D.C.Cir. 1986), citing *United Gas Pipe Line Co. v. McCombs*, 442 U.S. 529, 99 S.Ct. 2461, 61 L.Ed.2d 54 (1979). In the light of this, what the Commission requires is nothing more than that the pipeline, choosing to terminate its gas merchant function

[14] This decision if relevantly significant is, of course, binding on me.

[15] R. 7429 (citation omitted).

under GFN, must nevertheless continue to provide its transport service.

Finally, as the Commission explains so vividly, (R. 7428-7430), there are practical necessities sustaining the administrative reasonableness of the Commission's action. Not to require the pipeline to continue its transportation service would seriously impair if not completely undercut, the availability of market-priced gas to the market. It would also offset the consequences of the GFN. Significantly, the only interstate pipelines subject to this mandatory transportation are those few non-"open access" pipelines. Whatever the rights of these very few[16] non-"open access" pipelines—none involved here—their rights ought not to pull down the whole house of cards as to those already bound[17] to transport under "open access" requirements.

Take or Pay Solution not Mandatorily Required

Probably the most startling part of the Court's opinion is its presuming to direct the Commission to consider, and once and for all to *solve*, a matter so perplexing and complex as the issue of take-or-pay contracts.

Granted that it is a serious problem and one which needs a solution if—and the if may be a very big one—it can be solved independently of the ultimate insolvency of major pipeline takers and payers.

[16] All but two of the twenty-one major pipelines are consensually "open access." *See* n. 34, Court's opinion.

[17] Ironically, indicating perhaps the simple reflex of opposition by so many to any and every new effort to unscramble natural gas [problems], is the fact that joining the Joint Opponents' briefs are a number of party-pipelines who have accepted "open access." *See, e.g., Transcontinental Gas Pipe Line Corp.*, 43 FERC ¶ 61,196 (1988); *Tennessee Gas Pipeline Co.*, 39 FERC ¶ 61,337 (1987); *Natural Gas Pipeline Co. of America*, 39 FERC ¶ 61,153 (1987); *Williams Natural Gas Co.*, 43 FERC ¶ 62,171 (1988); and *ANR Pipeline Co.*, 44 FERC ¶ 61,126 (1988).

As this very Court has recognized in rejecting similar arguments, the take-or-pay issue is a discreet matter, "which is being addressed in other proceedings before the Commission and through other means." *Transwestern Pipeline Co. v. FERC*, 820 F.2d 733, 744 (5th Cir. 1987).[18]

Indeed, the demand that the Commission—under penalty of forfeiting its judgmental conclusion on increased price for old gas, abandonment and mandatory transportation —consider and then solve this problem of which Congress has been acutely aware, and has similarly ducked, is, most charitably, audacious. So audacious is it that it approaches a similar demand by some court someplace that either Congress or the Department of Defense solve the problem of terrorism as a condition to appropriating funds for the maintenance and upkeep of the prisoner stockade at Fort Sam Houston, Texas.

This is contrary to the demands not only of administrative law, but of the review of legislation, state or federal. The Supreme Court has long recognized that "[e]vils in the same field may be of different dimensions and proportions, requiring different remedies. . . . [O]r the reform may take one step at a time, addressing itself to the phase of the problem which seems most acute to the legislative mind." *Williamson v. Lee Optical of Oklahoma, Inc.*, 348 U.S. 483, 489, 75 S.Ct. 461, 465, 99 L.Ed. 563

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[18] The Commission's brief advises the Court that the Commission is particularly addressing these issues in the proceedings on remand of *Associated Gas Distributors*, Order No. 500; Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol: Interim Rule and Statement of Policy [Reg. Preambles 1982-1985], III FERC Stats. & Regs. ¶ 30,761 (1987), *modified and reh'g denied*, Order No. 500-B, III FERC Stats. & Regs. ¶ 30,772, *further modified*, Order No. 500-C, III FERC Stats. & Regs. ¶ 30,786 (1987), Order No. 500-D, III FERC Stats & Regs. ¶ 30,800 (March 8, 1988), *reh'g denied*, Order No. 500-E, 43 FERC ¶ 61,234 (May 6, 1988), 53 Fed.Reg. 16,859 (May 12, 1988); petitions for review filed *sub nom. American Gas Association v. FERC*, (D.C.Cir. No. 87-1588).

(1955); *see also Schweiker v. Wilson*, 450 U.S. 221, 238, 101 S.Ct. 1074, 1084, 67 L.Ed.2d 186 (1981).

Additionally, the Commission provides pipelines with the means to address take-or-pay problems within the context of its rulemaking. First, pipelines are given something tangible (higher old gas prices) to bargain against take-or-pay liability. Second, when producers, under GFN, seek to raise an old gas price, pipelines can require the direct renegotiation of the sellers' high-cost gas sales that are being sold under mixed contracts. Third, the pipeline can terminate its contract obligations as to both the old gas and high-cost gas sold under mixed contracts. In short, as the Commission found, the pipelines were given substantial bargaining leverage against producers' uneconomic contracts.[19]

Tag Ends

Like the Court in its opinion, I find undeserving of specific comment the other attacks on the Commission's 451 Orders.

Where it All Ends

Committed, as we are, to the Commission's necessitous right of experimentation in a matter so complex and nearly beyond congressional solution, this Court's action in nullifying the 451 Orders is an unauthorized intrusion into a field which neither Article III nor legislation commands.

I therefore, respectfully dissent.

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[19] The Commission's brief advises that to date under the Commission Order No. 500 series, eight pipelines have reached in the aggregate over $3.9 billion in settlements of take-or-pay liability. *See* Commission's brief, at note 55 (citing specific cases).

APPENDIX B

IN THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

No. 86-4940

MOBIL OIL EXPLORATION and PRODUCING SOUTHEAST, INC., *et al.*,
Petitioners,

versus

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

Petitioners for Review of an Order of the Federal Energy Regulatory Commission

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ON PETITIONS FOR REHEARING AND SUGGESTIONS FOR REHEARING EN BANC
(Opinion 9/15/89, 5 Cir., 198 —, —— F.2d ——)

(December 15, 1989)

Before CLARK, Chief Judge, BROWN and JOHNSON, Circuit Judges.

PER CURIAM:

(X) The Petitions for Rehearing are DENIED and no member of this panel nor Judge in regular active service on the Court having requested that the Court be polled on rehearing en banc, (Federal Rules of Appellate Procedure and Local Rule 35) the Suggestions for Rehearing En Banc are DENIED. Judge Brown continues in his dissent.

ENTERED for the COURT:

/s/ Sam Johnson
United States Circuit Judge

APPENDIX C

SUPREME COURT OF THE UNITED STATES

No. A-503

MOBIL OIL EXPLORATION & PRODUCING SOUTHEAST, INC., *et al.*,
Applicants,

v.

UNITED DISTRIBUTION COMPANIES, *et al.*

ORDER

UPON CONSIDERATION of the application of counsel for the applicants,

IT IS ORDERED that the mandate of the United States Court of Appeals for the Fifth Circuit, case No. 86-4940, is stayed pending receipt of responses to the application and further order of the undersigned or of the Court.

/s/ BYRON R. WHITE
Associate Justice
of the Supreme Court
of the United States

Dated this 10th day of January, 1990.

APPENDIX D

SUPREME COURT OF THE UNITED STATES

No. A-503

MOBIL OIL EXPLORATION & PRODUCING SOUTHEAST, INC., *et al.*,
Appellants,
v.

UNITED DISTRIBUTION COMPANIES, *et al.*

ON CONSIDERATION of the application for stay of mandate of the United States Court of Appeals for the Fifth Circuit presented to Justice White and by him referred to the Court,

IT IS ORDERED by this Court that the said application be, and the same is hereby, granted and the mandate is stayed pending the timely filing and disposition of the petitions for writs of certiorari. If the petitions for writs of certiorari are denied, this order terminates automatically. Should the petitions for writs of certiorari be granted, this order is to remain in effect pending the sending down of the judgment of this Court.

January 16, 1990

APPENDIX E

Regulations Adopted or Amended Pursuant to Orders 451 and 451-A, 18 C.F.R. Part 154 et seq.

§ 157.301 Blanket certificate authority, pre-granted abandonment, and reporting requirements.

(a) *Blanket certificate authority.* Any first seller of natural gas that is authorized to abandon the sale of gas under the good faith negotiation procedures set forth in § 270.201 of this chapter is granted a certificate of public convenience and necessity to sell such gas for resale in interstate commerce, subject to the reporting requirements of paragraph (c) of this section.

(b) *Pre-granted abandonment.* Any first seller who sells natural gas under the blanket certificate authority of paragraph (a) of this section is authorized to abandon the sale upon termination of the contract under which the sale is made.

(c) *Reporting requirement.* Any first seller who makes sales under the blanket certificate authority of this section must file a report with the Commission not later than April 1 of each year providing the following information with respect to any sales under that certificate initiated during the preceding calendar year:

(1) Name of former purchaser;

(2) Name of new purchaser;

(3) Location of sale (field, block, county, state, etc.);

(4) Contract date;

(5) Contract term;

(6) Average price; and

(7) Estimated annual sales volume (mcf).

(d) *Waiver of rate filing requirements.* The rate filing requirements of §§ 154.92 and 154.94 of this chapter are

waived for sales under a certificate granted by this section.

§ 270.201 Good faith negotiation procedures.

(a) *Applicability, definitions, and general rules.* (1) This section applies to requests for renegotiation of the price of old gas sold under an existing contract.

(2) For purposes of this section:

(i) "Old gas" means natural gas which, if sold, would be subject to a maximum lawful ceiling price under section 104 or 106(a) of the NGPA.

(ii)(A) "Existing contract" means a contract in effect on July 18, 1986, or an expired contract pursuant to which sales of natural gas are continuing on that date under the service obligation of a certificate of public convenience and necessity, that includes the sale of any old gas and provides authority for the first seller to collect a higher price upon establishment by the Commission of a higher maximum lawful price.

(B) An existing contract includes the sale of old gas if, on July 18, 1986, the contract encompasses the sale of any gas that has not been abandoned under section 7(b) of the Natural Gas Act and which, if sold, would be priced as old gas, whether or not any old gas is sold on that date.

(iii) The terms "first seller" and "party to a contract" include:

(A) An owner of a working interest in an oil or gas lease that has a direct contractual relationship with a purchaser for a "first sale" of gas, as defined in section 2(21) of the NGPA; and

(B) An operator of an oil or gas lease that has a direct contractual relationship with a purchaser for a "first sale" on behalf of any owner of a working interest in the lease that does not have such a relationship.

(3)(i) Any existing contract under which old gas is sold may be renegotiated or amended at any time to provide for a price up to the alternative maximum lawful price under § 271.402(c)(7)(i) of this chapter without using the good faith negotiation procedures.

(ii) A price for old gas that exceeds the otherwise applicable maximum lawful price under § 271.402 of this chapter may be collected under an existing contract only if the first seller and purchaser agree upon a price up to the alternative maximum lawful price under § 271.402(c)(7)(ii) in accordance with this section.

(4) A party to an existing contract may not request a nomination of a price under the provisions of this section for any gas sold under the contract, if that party:

(i) And the purchaser or first seller have renegotiated the price or any other term for the sale of any old gas under the contract after July 18, 1986, without using the good faith negotiation procedures of this section, and have not agreed in writing to preserve their rights under this section;

(ii) Has previously requested nomination of a price under paragraph (b)(1) of this section for any gas sold under the contract; or

(iii) Has been requested under this section to nominate a price for any gas sold under the contract, and the last date has passed under paragraphs (b)(2) or (b)(3) of this section to request the other party to nominate a price for gas sold under the contract.

* * * * *

(6) Any request for nomination of a price under this section, any nomination of a price in response to such a request, and any notice of abandonment of sales or termination of purchases under this section must be sent by U.S. mail, return receipt requested.

(7) Any deadline under this section for requesting a nomination of a price, or for nominating a price in re-

sponse to such a request, may be extended by mutual agreement of the parties in writing. Any notice required under this section to be given before a first seller or purchaser abandons or terminates sales or purchases may be shortened by mutual agreement of the parties in writing.

(8) A party nominating a price may propose a change in any other terms of the existing contract, and for purposes of this section, the terms "nominated price" and "nomination" may include such a proposed change.

(b) *Requests for negotiation and nomination of price.*

(1)(i) At any time after January 23, 1987, a first seller may request the purchaser to nominate a price at which the purchaser is willing to continue buying old gas under any existing contract by submitting a written request to the purchaser, and may specify the wells or category of wells under each contract for which the first seller requests a renegotiated price.

(ii) When requesting a nomination of a price under this paragraph, a first seller may also request the purchaser to provide the first seller with a current list of all of the purchaser's firm sales customers, including the name and address of an employee or agent responsible for negotiating purchases of natural gas on behalf of the customer. The purchaser must send the list of customers to the first seller within 30 days after receiving the request, and must include a certificate of its completeness and accuracy. The list must be sent by U.S. mail, return receipt requested.

(2) Within 30 days after receiving a request for nomination of a price under paragraph (b)(1) of this section, the purchaser may request the first seller to nominate a price at which the first seller is willing to continue selling any gas, including old gas for which the first seller has requested a nomination of price by the purchaser, under

any existing contract with the purchaser that includes the sale of any old gas, whether or not named in the first seller's request, by submitting a written request to the first seller.

(3) Within 30 days after receiving a request from a purchaser for nomination of a price for any gas under a contract that is not named in the first seller's request and that includes the sale of any old gas, the first seller may request the purchaser to nominate a price at which the purchaser is willing to continue buying any old gas under that contract, including old gas for which the purchaser has requested a nomination of price by the first seller, by submitting a written request to the purchaser.

(4) A first seller's request for nomination of a price under paragraph (b)(1) of this section constitutes an offer to release the purchaser from its contract obligation to purchase any gas sold under any existing contract with the first seller, whether or not named in the first seller's request, that includes the sale of any old gas.

* * * * *

(c) *No response to request for nomination.* (1) If the purchaser does not nominate a price in writing within 60 days after receiving the first seller's request for nomination of a price, the first seller may offer to sell all or part of the gas named in its request for nomination to a new purchaser. The first seller is authorized, upon 30-days written notice to the existing purchaser, to abandon the sale of the gas if the first seller enters into a written contract for the sale of all or part of the gas to a new purchaser after any necessary compliance with paragraph (g) of this section.

(2) If the first seller does not nominate a price in writing within 60 days after receiving the purchaser's request for nomination of a price, the purchaser may terminate its purchases of all or part of the gas named in its re-

quest for nomination at any time upon 60-days written notice to the first seller.

(d) *Purchaser's nomination of highest price.* If the purchaser nominates in writing the highest price to which an existing contract price could escalate with the purchaser's agreement under § 271.402(c)(7)(ii) of this chapter, and the purchaser does not propose a change in any term of the contract, sales must continue at the nominated price under the terms of the existing contract.

(e) *Purchaser's nomination of lower price; first seller's options.* (1) If the purchaser nominates in writing a price less than the highest price to which the existing contract price could escalate or proposes a change in any other term of the contract, the first seller must accept or reject the nominated price in writing within 30 days after receiving the nomination. If the first seller does not accept the purchaser's nominated price in writing within 30 days, the nominated price is deemed rejected.

(2) If the first seller accepts the nominated price, sales must continue at the agreed-upon price under the other terms of the existing contract, unless such terms are renegotiated by the parties.

(3) If the first seller rejects the nominated price, the first seller must continue sales to the purchaser at the existing price until the sale of the gas is abandoned under this paragraph. At any time after a rejection, the first seller may offer to sell to a new purchaser all or part of the gas for which no price is agreed upon under this paragraph.

(4) A first seller is authorized, upon 30-days written notice to the existing purchaser, to abandon the sale of any gas offered under this paragraph for which the first seller enters into a written contract with a new purchaser after any necessary compliance with paragraph (g) of this section.

(f) *First seller's nomination of price; purchaser's options.* (1) If the first seller nominates a price in writing in response to the purchaser's request under paragraph (b)(2) of this section, the purchaser must accept or reject the nominated price in writing within 30 days after receiving the nomination. If the purchaser does not accept the first seller's nominated price in writing within 30-days, the nominated price is deemed rejected.

(2) If the purchaser accepts the nominated price, purchases must continue at the agreed-upon price under the other terms of the existing contract, unless such terms are renegotiated by the parties.

(3) If the purchaser rejects the nominated price, the purchaser may at any time terminate its purchases of all or part of the gas named in its request for nomination upon 60-days written notice to the first seller.

(4) The terms of the existing contract apply until the purchaser accepts the first seller's nominated price or terminates purchases of the gas under this paragraph.

(5) A first seller is authorized to abandon sales of the gas to the purchaser if the purchaser terminates purchases of gas under this section and the first seller enters into a written contract for the sale of the gas to a new purchaser after any necessary compliance with paragraph (g) of this section.

(g) *Existing firm sales customers' right of first refusal*—(1) *General rule.* (i) If the first seller offers to sell gas subject to release due to termination or abandonment under paragraphs (c), (e), or (f) of this section ("offer") to a new purchaser that is not an existing firm sales customer of the existing purchaser, the first seller must present the same offer to all existing firm sales customers, if:

(A) The existing purchaser is not subject to the nondiscriminatory access provisions of § 284.8(b) or § 284.9(b) of this chapter, and;

(B) The offer encompasses the sale of any gas subject to the Commission's jurisdiction under section 1(b) of the Natural Gas Act and is substantially accepted in principle by the new purchaser in an arms-length transaction.

(ii) Any existing firm sales customer has a right of first refusal to purchase the gas under the terms of the offer. The offer must be presented in accordance with the provisions of this paragraph.

(2) *Making the offer.* The offer to a new purchaser that is not an existing firm sales customer must be presented to all such customers of the existing purchaser not later than 10 days after the offer is substantially accepted in principle by the new purchaser. The offer must be tendered by U.S. mail, return receipt requested.

(3) *Acceptance and rejection of offer; no counteroffer.* (i) An existing firm sales customer must accept the offer in writing within 20 days after receiving the offer. The offer is deemed accepted when it is signed and placed in the U.S. mail, return receipt requested. If the offer is not accepted by an existing firm sales customer within 20 days of its receipt, the offer is deemed rejected.

(ii) Any written counteroffer by an existing firm sales customer constitutes a rejection.

(iii) If the first seller receives more than one acceptance from an existing firm sales customer, the first seller may determine which such customer will become the new purchaser.

(4) *Termination of right of first refusal.* If no existing firm sales customer accepts the offer made under this paragraph within 20 days of receiving the offer, the first seller may execute a written contract with the new purchaser that substantially accepted the offer before it was sent to the existing firm sales customers. Such written contract with a new purchaser is not subject to a right of first refusal.

(5) *Definition.* For purposes of this section, "existing firm sales customer" means a customer with which the existing purchaser has a contract for the sale of gas not subject to a prior claim by another customer or another class of service, and at the same priority as any other class of firm service, which is in effect on the date a new purchaser substantially accepts in principle an offer under paragraph (g)(1) of this section.

(h) *Transportation by existing pipeline purchaser.* A purchaser that is an interstate pipeline not subject to the non-discriminatory access provisions of § 284.8(b) or § 284.9(b) of this chapter must transport any gas released due to termination or abandonment under this section, on behalf of any shipper, to any existing customer of the interstate pipeline or to any pipeline to which the interstate pipeline is interconnected, and in accordance with § 284.225 of this chapter, if the purchaser:

(1) Does not submit a timely nomination of a price for gas under paragraph (c)(1) of this section in response to the first seller's request for nomination of a price;

(2) Nominates a price under paragraph (e)(1) of this section that is less than the highest price to which its existing contract price could escalate if it were a new or amended contract;

(3) Terminates purchases of gas under paragraph (c)(2) of this section when the first seller does not submit a timely nomination of a price; or

(4) Terminates purchases of gas under paragraph (f)(3) of this section after rejecting a price for gas nominated by the first seller.

§ 271.402 Maximum lawful prices.

* * * * *

(c) *Applicable higher rates.* * * *

(3) In the case of any first sale under any rollover contract to which this subpart applies, the maximum lawful price for the month in which the effective date of such rollover contract occurs is the highest of:

(i) the maximum lawful price applicable to the expiring contract in the month in which the rollover contract becomes effective;

(ii) the price specified in Table II of § 271.101(a) for interstate rollover gas; or

(iii) the price specified in Table II of § 271.101(a) for post-1974 gas if the rollover contract becomes effective after July 18, 1986.

* * * * *

(5) Any seller seeking to charge a rate in excess of the applicable maximum lawful price described in paragraphs (a), or (c)(1), (c)(2), or (c)(7) of this section must file a petition seeking special relief fully justifying the relief sought. * * *

* * * * *

(7) The maximum lawful price, per MMBtu, for the first sales of all categories of gas otherwise subject to lower maximum lawful prices under this subpart is the price specified in Table II or § 271.101(a) for post-1974 gas, if the price is established:

(i) Under a contract or contract amendment executed after July 18, 1986; or

(ii) In accordance with the good faith negotiation procedures of § 270.201 of this chapter.

§ 271.602 Maximum lawful price.

(a) *General rule.* The maximum lawful price for a first sale of natural gas under an intrastate rollover contract to which section 106(b)(1) of the NGPA applies is the highest of:

(1)(i) The maximum lawful price, per MMBtu, paid under the expired contract in the month in which the rollover contract becomes effective; and

(ii) In any month after the month in which the rollover contract becomes effective, the maximum lawful price, per MMBtu, prescribed under this paragraph for the preceding month adjusted for inflation in accordance with § 271.102;

(2) the alternative maximum lawful price specified in Table I of § 271.101(a) for certain intrastate rollover gas; or

(3) the price specified in Table II of § 271.101(a) for post-1974 gas, if the price is established under a contract or contract amendment executed after July 18, 1986.

* * * * *

§ 284.225 Transportation by interstate and intrastate pipelines of gas released under the good faith negotiation procedures.

(a) *Applicability.* This section applies to any interstate pipeline that must transport natural gas under paragraph (h) of the good faith negotiation procedures in § 270.201 of this chapter, and to any intrastate pipeline that purchased gas immediately before its release due to termination or abandonment under § 270.201(c), (e), or (f) of this chapter.

(b) *Blanket certificate for interstate pipelines.* An interstate pipeline is granted a blanket certificate of public convenience and necessity that authorizes firm and interruptible transportation of natural gas to any existing customer of the interstate pipeline or to any pipeline to which the interstate pipeline is interconnected, if the gas is released due to termination or abandonment under § 270.201(c), (e), or (f) of this chapter.

* * * * *

(d) *Definition.* For purposes of this section, "existing customer" means a customer with which the interstate or intrastate pipeline has a contract for the sale or transportation of gas which is in effect on the date a written contract is executed to purchase the gas for which transportation service is available under this section.

(e) *Transportation rates*—(1) *Transportation service within contract demand.* If a pipeline provides transportation of gas to an existing customer under this section and, as a result, the total volumes of gas sold and transported to that customer on a firm basis do not exceed existing firm contract demand by that customer, the interstate pipeline:

(i) Must base its transportation rate for such gas on the rate in a transportation rate schedule on file with the Commission that conforms to § 284.7 and § 284.8(d);

(ii) Must waive any transportation reservation fee to the extent that a customer pays for facilities associated with such transportation service through demand charges under its firm sales rate schedule;

(iii) Must credit the volumes of gas transported against any minimum commodity bill obligation; and

(iv) May recover costs, on an Mcf or MMBtu basis, associated with standing by to serve a firm sales rate schedule customer that does not reduce its contract demand, if the interstate pipeline revises its sales rate schedules on file with the Commission.

(2) *Transportation service in excess of contract demand.* If an interstate pipeline provides transportation of gas to an existing customer under this section and, as a result, the total volumes of gas sold and transported to that customer exceed existing firm contract demand to that customer, the transportation rate for such gas must be the rate in a transportation rate schedule on file with the Commission that conforms to § 284.7 and either

§ 284.8(d) for firm service or § 284.9(d) for interruptible service.

(3) *Transportation service for other customers.* If an interstate pipeline provides transportation of gas under this section to any pipeline or customer other than an existing customer on a firm basis, the transportation rate for such gas must be the rate in a transportation rate schedule on file with the Commission that conforms to § 284.7 and either § 284.8(d) for firm service or § 284.9(d) for interruptible service.

(4) *Interim rates.* If an interstate pipeline does not have a transportation rate schedule on file with the Commission that conforms to § 284.7 and either § 284.8(d) for firm service of § 284.9(d) for interruptible service, the interstate pipeline must file such a rate schedule within 60 days after first providing transportation service under this section. Until such a rate schedule becomes effective, the interstate pipeline must provide the transportation service using the rate in one of the interstate pipeline's transportation rate schedules on file with the Commission which the interstate pipeline determines covers service comparable to transportation service authorized under this section.

* * * * *

(g) *Reporting requirements.* An interstate pipeline that transports gas under a certificate granted by this section is subject to the reporting requirements of § 284.223(f). An intrastate pipeline that transports gas under a certificate granted by this section is subject to the reporting requirements of § 284.126.

(h) *Terms and conditions of service.* (1) The terms and conditions of service provided under a blanket certificate granted by this section must conform to the transportation requirements of the shipper, subject to reasonable operating conditions of the pipeline and its available pipeline capacity.

(2) An interstate pipeline that transports gas under a certificate granted by this section and is not otherwise subject to the non-discriminatory access provisions of § 284.8(b) or § 284.9(b) is not required to transport on behalf of others any gas not released due to termination or abandonment under the good faith negotiation procedures of § 270.201 of this chapter.

(3) If a pipeline that transports gas under a certificate granted by this section becomes subject to the non-discriminatory access provisions of § 284.8(b) or § 284.9 (b), its authority and service obligation under the certificate to transport gas purchased under a contract in effect before the pipeline becomes subject to those provisions terminates only when the contract expires or is terminated.

§ 284.226 Transportation by interstate and intrastate pipelines upstream of pipelines releasing gas under the good faith negotiation procedures.

(a) *Applicability.* This section applies to any upstream interstate or intrastate pipeline that is not subject to the non-discriminatory access provisions of § 284.8 (b) or § 284.9(b) of this chapter and that provided transportation of gas immediately prior to its release by any interstate or intrastate pipeline due to termination or abandonment under the good faith negotiation procedures in § 270.201 of this chapter. Such upstream pipelines were those authorized under any Commission regulation to transport natural gas, prior to the release of that gas due to termination or abandonment under § 270.201(c), (e), or (f) of this chapter, along any line between the wellhead and the pipeline that purchased the gas immediately before its release.

(b) *Blanket Certificate.* (1) Upstream interstate pipelines are granted a blanket certificate of public convenience and necessity that authorizes transportation of natural gas released due to termination or abandonment

under § 270.201 (c), (e) or (f) of this chapter on behalf of any shipper to any interstate pipeline releasing gas under § 270.201 of this chapter, under the same terms and conditions as previously provided to the releasing pipeline.

* * * * *

(c) *Transportation rates.* The rates charged by such third-party, upstream pipelines for transportation under this section shall be identical to the rates charged under any pre-existing transportation authorization for the same service previously provided to the releasing pipeline.

(d) *Reporting requirements.* An interstate pipeline that transport gas under the certificate granted by this section is subject to the reporting requirements of § 284.223(f). An intrastate pipeline that transports gas under the certificate granted by this section is subject to the reporting requirements of § 284.126.

APPENDIX F

Following is list of the petitioners joining this Application. Petitioners are listed in capital letters. Pursuant to Rule 29.1, parent companies and subsidiaries (except wholly owned subsidiaries), if any, are listed under each such petitioner.

AMOCO PRODUCTION COMPANY

Amoco Company (parent)
Amoco Corporation (parent)
East Texas Salt Water Disposal Company
Gravcap, Inc.
Heat Transfer Research, Inc.
Sultran, Ltd.

ANADARKO PETROLEUM CORPORATION

(Anadarko Petroleum has no parent corporation or subsidiaries other than those it wholly owns.)

ARCO OIL & GAS COMPANY

Atlantic Richfield Company (parent)
85819 Canada Limited
Agro Internacional, S. de R. L. de C.V.
Alyeska Pipeline Service Company
ARCO Channelview, Inc.
ARCO Chemical Company
ARCO China Inc.
ARCO Solar Nigeria Ltd.
Badger Pipeline Company
Black Lake Pipe Line Company
Blair Athol Coal Pty, Limited
Colonial Pipeline Company
Compania de Petroleo Ganso Azul, Ltda
Compania Minera Dos Republicas S.A. de C.V.
Cook Inlet Pipe Line Company
Dixie Pipeline Company
East Texas Salt Water Disposal Co.
Iricon Agency Ltd.

Kenai Pipe Line Company
Kuparuk Transportation Company
Las Quintas Serenas Water Company
Logan Aluminum Inc.
Lyondell Petrochemical Company
Murlfill Pty. Ltd.
Platte Pipe Line Company
Showa ARCO Solar Far East Pte. Ltd.
Tecumseh Pipe Line Company
Texas-New Mexico Pipe Line Company

ASHLAND EXPLORATION, INC.

Ashland Exploration Holdings, Inc. (parent)
(Ashland Exploration, Inc. has no subsidiaries other than those it wholly owns.)

CHEVRON U.S.A. INC.

Chevron Corporation (parent)
Atlas Supply Company
Felix Oil Company
Pembroke Company, Inc.

CONOCO, INC.

E. I. Du Pont De Nemours, Inc. (parent)
Big Sky of Montana Realty, Inc.
Cit-Con Oil Corporation
Conch International Methane Ltd.
Conoco Amazonos Limited
Conoco Arabia Limited
Conoco Buton Ltd.
Conoco Cabinda (Angola) Ltd.
Conoco Cegonha (Angola) Ltd.
Conoco Dabaa Ltd
Conoco El Hamma (Tunisia) Ltd.
Conoco Faghur Ltd.
Conoco Iraq Ltd.
Conoco Kayes (Congo) Ltd.

Conoco Kouilou (Congo) Ltd.
Conoco N-dombo (Gabon) Ltd.
Conoco North Ras Qattara Ltd.
Conoco North Sitra Ltd.
Conoco Onango (Gabon) Ltd.
Conoco Peru
Conoco South Umbarka Ltd.
Conoco Spain Ltd.
Conoco Warim Ltd.
Conoco West Ras Qattara Ltd.
Conoco Yemen (Aden) Ltd.
Conoco Yemen (Sanaa) Ltd.
Dubai Exploration Onshore Company
Felix Oil Company
Jupiter Chemicals, Inc.
Kettleman North Dome Association
Oberrheinische Mineraloelwerke
Petrocokes, Ltd.
Petroleum Terminals, Inc.
The Standard Shale Products Company
Tidelands Royalty Trust

EXXON CORPORATION

(Exxon Corporation has no parent corporation.)
Exxon Capital Corporation
Exxon Capital Holdings Corporation
Exxon Capital Ventures Inc.
Exxon Credit Corporation
Exxon Financial Services Company Limited
Exxon Funding B.V.
Exxon Pipeline Company
Exxon Shipping Company
Exxon Supply Company
Imperial Oil Limited
Interhome Energy Inc.
Scurry-Rainbow Oil Limited

HUNT OIL COMPANY

Hunt Consolidated, Inc. (parent)
Portal Pipe Line Company
Poloma Pipe Line Company

MARATHON OIL COMPANY

USX Corporation (parent)
Arctic LNG Transportation Company
Kenai LNG Corporation
Oil Insurance Limited
Polar LNG Shipping Corporation

MOBIL OIL EXPLORATION & PRODUCING SOUTHEAST, INC.

Mobil Corporation (parent)
Paloma Pipe Line Company

ORYX ENERGY COMPANY

(Oryx Energy Company has no parent corporation.)
Sun Energy Partners, L.P.

OXY USA Inc.

Occidental Petroleum Corporation (parent)
(Oxy USA Inc. has no subsidiaries other than those it wholly owns.)

PENNZOIL COMPANY

(Pennzoil Company has no parent corporation.)
Jiffy Lube International, Inc.
Proven Properties, Inc.
Pennzoil (U.K.) Limited

PHILLIPS PETROLEUM COMPANY

(Phillips Petroleum Company has no parent corporation.)
Venezoil, C.A.

PHILLIPS 66 NATURAL GAS COMPANY

Phillips Petroleum Company (parent)
Kenai LNG Corporation
Arctic LNG Transportation Company
Polar LNG Shipping Corporation

PLAINS PETROLEUM CO.

(Plains Petroleum Co. has no parent corporation or subsidiaries other than those it wholly owns.)

ROSEWOOD RESOURCES, INC.

(Rosewood Resources has no parent corporation or subsidiaries other than those it wholly owns.)

SHELL OFFSHORE INC.

Shell Oil Corporation (parent)
(Shell Offshore, Inc. has no subsidiaries other than those it wholly owns.)

SHELL WESTERN E & P INC.

Shell Oil Corporation (parent)
East Texas Salt Water Disposal Company
Grande Ecallie Land Company
Van Salt Water Disposal Company
Wyoming Industrial Development Corporation

TEXACO INC.

(Texaco Inc. has no parent corporation.)
Getty Oil Company
Texaco Cogeneration Company
Texaco Pipeline Inc.
Texaco Producing Inc.
Texaco Refining and Marketing Inc.
Texaco Trading and Transportation Inc.
Norsk Texaco Oil A/S
S.A. Texaco Belgium N.V.

Texaco A/S
Texaco Britain Limited
Texaco Denmark Inc.
Texaco Investments (Netherlands), Inc.
Texaco (Ireland) Limited
Texaco Limited
Texaco North Sea U.K. Company
Texaco Oil Aktiebolag
Texaco Petroleum Maatschappij (Nederland) B.V.
Refineria Panama S.A.
Refineria Texaco de Honduras, S.A.
Texaco Brasil S.A.—Productos de Petroleo
Texaco Caribbean Inc.
Texaco Nigeria Limited
Texaco Panama Inc.
Texaco Petroleum Company
Texaco Puerto Rico Inc.
Texaco Trinidad, Inc.
Texaco Petroleum Company
Texaco Chemical Company
Texaco International Financial Corporation
Texaco International Trader Inc.
Texaco Overseas Holdings Inc.
Texaco Overseas Petroleum Company
Texaco Overseas Tankship Ltd.
Canada Texaco Inc.
Four Star Oil & Gas Company
Texaco Canada Petroleum Inc.
Texaco Refining and Marketing Holdings Inc.

UNION OIL COMPANY OF CALIFORNIA

Unocal Corporation (parent)
Union Exploration Partners, Ltd.
Unocal Thailand, Ltd.
Midwest 76, Inc.

UNION PACIFIC RESOURCES COMPANY

Union Pacific Corporation (parent)
CPC Resources Corporation

Golden Spike Indonesia, Inc.
Harbor Service Stations, Inc.
Quality Aggregate Company
Rocky Mountain Energy Company
Union Pacific Arguello Pipeline, Inc.
Union Pacific Australia PTY Ltd.
Union Pacific Energy Company
Union Pacific Fuels, Inc.
Union Pacific Gas Gathering, Inc.
Union Pacific Gas Pipeline, Inc.
Union Pacific Gas Processing Company
Union Pacific International Petroleum Company
Union Pacific Malaysia, Inc.
Union Pacific Minerals, Inc.
Union Pacific Petrochemicals, Inc.
Union Pacific Pipeline Company
Union Pacific Pipeline, Inc.
Union Pacific Refining, Inc.
Union Pacific Resources Inc.
Union Pacific Resources Indonesia, Inc.
Union Pacific Trading Company
UPR (Canada) Ltd.

UNION TEXAS PETROLEUM CORPORATION

Union Texas Petroleum Holdings, Inc. (parent)
Union Texas Exploration Corporation
Union Texas International Corporation

Nos. 89-1452, 89-1453

In The
Supreme Court of the United States
October Term, 1989

Mobil Oil Exploration and
Producing Southeast, Inc., *et al.*,
Petitioners,
v.
United Distribution Companies, *et al.*,
Respondents.

Federal Energy Regulatory Commission,
Petitioner,
v.
United Distribution Companies, *et al.*,
Respondents.

On Petitions for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

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RESPONSE OF RESPONDENTS PROCESS GAS CONSUMERS GROUP, AMERICAN IRON AND STEEL INSTITUTE, AND GEORGIA INDUSTRIAL GROUP IN SUPPORT OF PETITIONS

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QUESTIONS PRESENTED

1. Whether the Federal Energy Regulatory Commission has statutory authority to raise the ceiling price applicable to certain categories of gas under the Natural Gas Policy Act of 1978.

2. Whether the Commission has statutory authority under the Natural Gas Act to establish on a generic basis the conditions under which abandonments of service may be pre-authorized, instead of considering each abandonment request individually, in case-by-case adjudication.

3. Whether the Commission acted within its combined powers under the Natural Gas Act and the Natural Gas Policy Act of 1978 in developing its carefully crafted, complex, Order 451 program for eliminating persistent market distortions created by the effects of industry changes and vestigial wellhead price controls.

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v.

UNITED DISTRIBUTION COMPANIES, *et al.*,
Respondents.

No. 89-1453

FEDERAL ENERGY REGULATORY COMMISSION,
Petitioner,

v.

UNITED DISTRIBUTION COMPANIES, *et al.*,
Respondents.

On Petitions for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

---

RESPONSE OF RESPONDENTS PROCESS GAS CONSUMERS GROUP, AMERICAN IRON AND STEEL INSTITUTE, AND GEORGIA INDUSTRIAL GROUP IN SUPPORT OF PETITIONS

Respondents the Process Gas Consumers Group ("PGC"), the American Iron and Steel Institute ("AISI"), and the Georgia Industrial Group ("GIG") (collectively the "Industrial User Groups") respectfully request that this Court grant the Petitions for Writ of Certiorari sought herein in Docket Nos. 89-1452 and -1453 to review

the judgment and opinion of the United States Court of Appeals for the Fifth Circuit in *Mobil Oil Exploration and Producing Southeast, Inc. v. FERC*, 885 F.2d 209 (5th Cir. 1989), *rehearing denied*, —— F.2d —— (5th Cir., Dec. 15, 1989).

PGC is an unincorporated association of industrial consumers of natural gas, organized to promote the development and adoption of coordinated, rational, and consistent federal and state policies with respect to gas service to industrial process gas users. PGC members own and operate hundreds of plants in virtually every state in the nation.[1]

The American Iron and Steel Institute ("AISI") is the principal trade association of the domestic steel industry. It is an incorporated trade association with no parent or subsidiaries. Its 41 domestic member companies account for approximately 80% of the raw steel production capabilities in the United States.[2] AISI members use natural gas in a variety of manufacturing processes.

[1] The member companies of the Process Gas Consumers Group are: Alcan Aluminum Company; Aluminum Company of America; American National Can Company; Armco Inc.; Bethlehem Steel Corporation; Carpenter Technology Corporation; Cone Mills Corporation; Corning Incorporated; Eaton Corporation; Ford Motor Company; General Motors Corporation; LTV Steel Company; National Steel Corporation; Owens-Corning Fiberglas Corporation; Owens-Illinois, Inc.; PPG Industries, Inc.; and The Procter & Gamble Company.

[2] The member companies of the American Iron and Steel Institute are: Acme Steel Company; Armco Inc.; Atlantic Steel Company; Avesta Stainless Inc.; Berg Steel Pipe Corporation; Bethlehem Steel Corporation; Citisteel USA, Inc.; Cleveland-Cliffs Inc.; CSC Industries, Inc.; A. Finkl & Sons Co.; FirstMiss Steel, Inc.; Geneva Steel Company; Georgetown Industries, Inc.; Gulf States Steel, Inc.; M.A. Hanna Company; Harsco Corporation; Hi Specialty America; Inland Steel Industries, Inc.; Earle M. Jorgensen Company; Laclede Steel Company; Lone Star Steel Group, Lone Star Technologies, Inc.; LTV Steel, Inc.; Lukens Inc.; McLouth Steel Products Corporation; National Steel Corporation; North Star Steel Company, Ocean State Steel, Inc.; Oglebay Norton Company; Raritan River Steel Company; Republic Engineered Steels, Inc.; Rouge Steel Company; Sandvik Inc.; Sharon Tube Company; Shenango Incorporated; The Timken Company; USS, A Division of USX Corporation; Warren Consolidated Industries, Inc.; Weirton Steel Corporation; Wheatland Tube Company; Wheeling-Pittsburgh Steel Corporation; The Algoma Steel Corporation; Atlas Steel Inc.; Dofasco Inc.; IPSCO; QIT-Fer et Titane Inc.; Sidbec-Wosco Inc.; Stelco Inc.; Sydney Steel Corporation; Compania Siderurgica Huachipato S.A.; and Hylsa, S.A.

GIG is an unincorporated association of industrial users of natural gas located in the state of Georgia.[3] GIG members actively participate in a variety of state and federal proceedings affecting the prices of natural gas and electricity in the state of Georgia.

STATEMENT

Respondents the Industrial User Groups hereby adopt the Statement of Petitioner the Federal Energy Regulatory Commission.

REASONS FOR GRANTING THE PETITIONS

I. CERTIORARI SHOULD BE GRANTED BECAUSE OF THE SERIOUS ADVERSE IMPACTS, BOTH DIRECT AND INDIRECT, THE DECISION OF THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT WILL HAVE ON GAS CONSUMERS.

The United States Court of Appeals for the Fifth Circuit vacated Order Nos. 451 and 451-A of the Federal Energy Regulatory Commission ("FERC" or "Commission") because, it found, FERC had failed to adhere to

[3] The member companies of the Georgia Industrial Group are: Anglo-American Clays Corporation; Archer-Daniels-Midland Company; Burgess Pigment Company; Chemical Products Corporation; Engelhard Corporation; Ford Motor Company; General Motors Corporation; Georgia Kaolin Company; J.M. Huber; Nabisco Brands, Inc.; Nord Kaolin Company; The Procter & Gamble Company; Southwire Company; and Thiele Kaolin Company.

the consumer protective goals of the Natural Gas Act and the Natural Gas Policy Act of 1978 ("NGPA").[4] The Industrial User Groups are members of the prime constituency that the court below sought to protect, gas consumers. Nevertheless, the Industrial User Groups ask this Court to grant the Petitions for Certiorari and reverse the decision of the court below.

1. The court of appeals erred in failing to recognize that each of the details of FERC's Order No. 451 price ceiling increases and good faith negotiation procedures was fully within FERC's authority. Order Nos. 451 and 451-A did not achieve a *de facto* deregulation of old gas prices, as the court claimed,[5] but instead worked a legitimate, *de jure* administrative adjustment of gas prices to "just and reasonable" levels.

From the outset, the Industrial User Groups have supported the Commission's initiatives in the Order No. 451 program. Indeed, in response to the proposals originally advanced by the Department of Energy, the Industrial User Groups urged the Commission to establish a new, single, "just and reasonable" ceiling price for all "old" gas that was equivalent to the post-1974 vintage, and argued that it was empowered to do so. The Groups also contended that the Commission could (as it did) compel producers to renegotiate the prices charged for high-priced gas as part of the process of renegotiating the prices for "old," low-priced gas. The Groups' arguments on these issues are effectively presented in the Petitions and will not be repeated here. Accordingly, for the reasons set forth more fully by the Petitioners herein, the Industrial User Groups maintain that the Commission was fully authorized under Sections 4 and 5 of the Natural Gas Act, 15 U.S.C. §§ 717c, 717d (1988), and Sections 104(b)(2) and 106(a) of the NGPA, 15 U.S.C. §§ 3314(b)(2), 3316(c) (1988), to devintage certain "old" gas prices, and to apply a replacement cost methodology to establish a new "just and reasonable" ceiling applicable to that gas.

It is well established that the Commission has broad discretion in determining "just and reasonable" ceiling prices and may use a wide variety of methods in order to establish such prices consistent with its overall regulatory goals and responsibilities. *See Permian Basin Area Rate Cases*, 390 U.S. 747, 776 (1968) ("[t]he Commission's broad responsibilities . . . demand a generous construction of its statutory authority.") The Commission must be "'free . . . to devise methods of regulation capable of equitably reconciling diverse and conflicting interests.'" *American Pub. Gas Ass'n* v. *FPC*, 567 F.2d 1016, 1058 (D.C. Cir. 1977), *cert. denied*, 435 U.S. 907 (1978), *citing Mobil Oil Corp. v. FPC*, 417 U.S. 283, 331 (1974). "[T]he breadth and complexity of the Commission's responsibilities demand that it be given every reasonable opportunity to formulate methods of regulation appropriate to the solution of its intensely practical difficulties." *Permian Basin*, 390 U.S. at 790.

The Commission thoroughly documented the serious market distortions and severe regional price disparities that were impairing its efforts to adhere to the intent of the NGPA Congress and create a truly national gas market. Taking into account the limitations on its statutory authority, FERC raised ceiling prices for only those categories of gas as to which the NGPA gave it explicit authority to do so. It conservatively adopted as the new ceiling price for this gas the post-1974 vintage price, which had already been found by a reviewing court to be a "just and reasonable" price. *See American Pub. Gas Ass'n v. FPC*, 567 F.2d at 1053, 1063-64. FERC also crafted a detailed, complex, good faith negotiation mechanism, each stage of which was deliberately designed

[4] Appendix A at 3a, 6a, 8a n.12, 20a-21a, 36a. References to Appendix A herein denote pages in Appendix A of the Petition of the Federal Energy Regulatory Commission.

[5] Appendix A at 11a.

to fulfill its regulatory responsibilities. Importantly, the Commission took these actions in response to the "intensely practical difficulties" it faced as gas markets changed and regional price disparities engendered by vestigal wellhead price controls grossly distorted energy prices paid by consumers (including Industrial User Group members), merely by their fortuitous location in different parts of the country.[6] If the decision of the Fifth Circuit court is allowed to stand and Order Nos. 451 and 451-A are vacated *ab initio*, six years of arduous market-ordering progress will be undone.

FERC also adopted Order Nos. 451 and 451-A in the expectation that an addition 11 Tcf of gas supplies, which otherwise would have been abandoned as uneconomic, would be produced.[7] Because no fuel will substitute for natural gas in "process uses," the availability of these significant additional gas supplies is very important to members of the Industrial User Groups.

The decision of the court below to vacate these orders will have an enormous, adverse impact not only on producers of "old gas," but on the Nation's gas consumers as well. In light of the enormous, real world impacts of the vacating of Orders Nos. 451 and 451-A, certiorari should be granted.

2. At the heart of FERC's several initiatives designed to introduce the benefits of competition into the gas industry is the need for the free alienability of gas supplies. Preauthorization for abandonment of gas service

[6] In proposing its rule, the Department of Energy noted that, due to historical accident, regional disparities in gas prices were unfairly harming industrial users in some areas of the country by comparison to their competitors located in regions where cheaper gas supplies were available. Ceiling Prices; Old Gas Pricing Structure, Notice of Proposed Rulemaking, 50 Fed. Reg. 48,540, 48,541-42 (1985).

[7] Order No. 451, 51 Fed. Reg. 22168 at 22180 (1986). FERC estimated that production of this gas would save consumers $25 billion. 51 Fed. Reg. at 22,172, 46,477; 50 Fed. Reg. at 48,540.

is an essential element to that alienability; today's markets often proceed on a month-to-month or even a week-to-week, basis. Individualized comparative needs hearings for each abandonment application, as would be required by the court below, are simply not pragmatically possible. For these reasons and the reasons set forth more fully in the Petitions, the Industrial User Groups assert that the court of appeals gravely erred in invalidating Order No. 451's pregranted abandonment feature.

The court's holding also conflicts with this Court's pronouncements in *FPC v. Moss*, 424 U.S. 494, 500 (1976). There this Court upheld FERC's authority to grant abandonments under Section 7(b) of the Natural Gas Act,[8] upon a finding that the *future* public convenience and necessity would be served. Pregranted abandonments make similar forward-looking findings. Moreover, the Fifth Circuit court's holding conflicts with recent decisions of the United States Court of Appeals for the District of Columbia Circuit,[9] and threatens FERC's Order Nos. 490 and 490-A, concerning Abandonments of Sales and Purchases of Natural Gas under Expired, Terminated, or Modified Contracts, which is presently before the Sixth Circuit.[10]

Invalidation of FERC's pregranted abandonment procedures will undermine literally thousands of ongoing contractual arrangements for the purchase and sale of natural gas. Industrial User Group members manufacture products that are highly sensitive to energy costs, and they thus purchase large amounts of gas on the spot market. Invalidation of FERC's pregranted abandonment regulations will disrupt the spot market and provoke an unprecedented realignment of gas supplies

[8] 15 U.S.C. § 717f(b) (1988).

[9] *See Kansas Power & Light Co. v. FERC*, 851 F.2d 1479, 1483-86 (D.C. Cir. 1988); *Associated Gas Distributors v. FERC*, 824 F.2d 981, 1015 n.17 (D.C. Cir. 1987), *cert. denied*, 485 U.S. 1006 (1988).

[10] 53 Fed. Reg. 4,121 and 29,002 (1988), *appeal docketed*, *Marathon Oil Co. v. FERC*, Nos. 88-3666, *et al.* (6th Cir. filed July 26, 1988).

among pipelines (thereby potentially exacerbating the very take-or-pay problem the court below faulted FERC for ignoring), and cause a massive shifting of economic rents among producers, pipelines, marketers, and consumers. The deleterious effects on consumers of the lack of access to Order No. 451-released gas, and to a spot market of economically priced gas that can be freely traded, cannot be overstated.

3. Judge Brown's dissent in *Mobil* details the importance of Order No. 451 to FERC's overall program that was designed to usher the natural gas industry into the new world of competition. Those arguments will not be repeated here. In light of the crucial significance of Order No. 451 to FERC's ongoing efforts to restructure the gas industry, however, the Industrial User Groups strongly believe that grant of the Petitions for Certiorari is fully warranted.

CONCLUSION

For the foregoing reasons, and the reasons set forth in the Petitions of the Federal Energy Regulatory Commission and Mobil Oil Exploration and Producing Southeast, Inc., *et al.*, the Petitions for Writ of Certiorari should be granted.

Respectfully submitted,

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April 5, 1990

Nos. 89-1452 and 89-1453

In the Supreme Court of the United States

OCTOBER TERM, 1989

MOBIL OIL EXPLORATION & PRODUCING SOUTHEAST, INC., ET AL., PETITIONERS

v.

UNITED DISTRIBUTION COMPANIES, ET AL.

FEDERAL ENERGY REGULATORY COMMISSION, PETITIONER

v.

UNITED DISTRIBUTION COMPANIES, ET AL.

ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENTS IN OPPOSITION

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QUESTION PRESENTED

Whether the court of appeals correctly ruled that Order No. 451 and Order No. 451-A of the Federal Energy Regulatory Commission are unlawful because:

(a) they violate Sections 104(b)(2) and 106(c) of the Natural Gas Policy Act of 1978 by effectively eliminating price regulation of old gas; and

(b) they violate Section 7(b) of the Natural Gas Act by authorizing automatic abandonment, at the producer's option, of contractual obligations to sell old gas.

PARTIES TO THE PROCEEDINGS

To supplement the list of parties provided in the petitions, and to comply with this Court's Rule 29.1, Appendix A contains a list of respondents. The list includes the parent companies and subsidiaries (except wholly owned subsidiaries) of each corporate respondent.

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STATEMENT OF THE CASE

Petitioners challenge a decision vacating two orders of the Federal Energy Regulatory Commission that effectively deregulated the prices of so-called "old gas." "Old gas" is low-cost natural gas that was already in production, dedicated to the interstate market, and regulated under the Natural Gas Act ("NGA"), 15 U.S.C. §§ 717 *et seq.* (1988), when Congress enacted the Natural Gas Policy Act ("NGPA"), 15 U.S.C. §§ 3301 *et seq.* (1988), in 1978. In the NGPA, Congress chose, after a lengthy

political battle, to retain price regulation for most old gas while gradually deregulating the price of new gas (*i.e.*, gas produced from wells that began production after the effective date of the NGPA). Eight years later, however, in June and December 1986, the Commission issued Order No. 451 and Order No. 451-A, which removed all effective price controls from old gas and thus violated the legislative compromise reflected in the NGPA.[1] The Commission purported to act under Sections 104(b)(2) and 106(c) of the NGPA, which authorize the Commission to increase the "maximum lawful ceiling price" for old gas as long as the ceiling price prescribed is "just and reasonable within the meaning of the Natural Gas Act." 15 U.S.C. §§ 3314(b)(2), 3316(c).

Soon after their issuance, Order No. 451 and Order No. 451-A were challenged by the numerous parties who are now respondents in this Court. Ironically, these are the very parties whom the Commission alleged would benefit from its action, but who in fact have been greatly harmed by it. The parties opposing the Commission's orders represent every segment of the natural gas industry except gas producers. They include a diverse group of consumer protection advocates, state public utility commissions (including those of California and New York), state offices of consumer counsel, interstate natural gas pipelines, municipally and privately owned local distribution companies, and trade associations representing local distribution company interests. Many of the respondents represent consumers who rely on natural gas to meet basic human energy needs.

By contrast, the parties defending the Commission's orders (in addition, of course, to the Commission itself) consist primarily of the actual beneficiaries of the Commission's action, large corporate producers of natural gas. These companies have reaped substantial profits as the Commission's orders have driven up the prices of old gas, and they are seeking review in this Court in an effort to preserve their gains.

[1] *See* Order No. 451, "Ceiling Prices; Old Gas Pricing Structure," 51 Fed. Reg. 22168-22223 (June 18, 1986); Order No. 451-A, "Ceiling Prices; Old Gas Pricing Structure," 51 Fed. Reg. 46762-46821 (December 24, 1986).

To place the current controversy in perspective, it is important to review the legislative context in which the Commission's orders were issued, as well as the impact of those orders in the marketplace and the relevant subsequent legislation enacted by Congress. This background, respondents believe, helps to demonstrate why the court of appeals' decision is correct and why review by this Court is not warranted.

A. Evolution of the NGA "Just and Reasonable" Standard.

This Court has long recognized that the primary objective of the NGA is protection of consumers from exploitation by natural gas companies. *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 610 (1944). The court of appeals in this case, citing *Hope*, correctly observed that in enacting the NGA in 1938, Congress chose "consumer protection as the overriding objective in the implementation of the nation's first natural gas regulatory scheme." Pet. App. 3a.[2]

To this end, Congress vested the Federal Power Commission (the predecessor of the Federal Energy Regulatory Commission) with comprehensive regulatory authority to control the terms and conditions under which natural gas service to the interstate market could be commenced or later abandoned. 15 U.S.C. §§ 717f(c) and (b); *United Gas Pipe Line Co. v. McCombs*, 442 U.S. 529, 535-536 (1979). Congress also vested the Commission with utility-type ratemaking control over the prices and supply of natural gas. *Transcontinental Gas Pipe Line Corp. v. State Oil & Gas Bd.*, 474 U.S. 409, 420

[2] "Pet. App." refers to the appendix to the government's petition, No. 89-1453.

(1986). And, by requiring that all rates and charges for federally regulated natural gas sales be "just and reasonable," 15 U.S.C. §§ 717c and d, the NGA afforded consumers "a complete, permanent and effective bond of protection from excessive rates and charges." *Atlantic Refining Co. v. Public Service Commission*, 360 U.S. 378, 388 (1959).[3]

In applying the "just and reasonable" standard, this Court ruled in *FPC v. Texaco Inc.*, 417 U.S. 380, 397 (1974), that "[t]he prevailing price in the marketplace cannot be the final measure of 'just and reasonable' rates mandated by the [NGA]." *See also Shell Oil Co. v. FPC*, 520 F.2d 1061, 1084 (5th Cir. 1975), *cert. denied*, 426 U.S. 941 (1976). This follows necessarily from the undisputed proposition that, by adopting the "just and reasonable" standard, Congress chose to *regulate* natural gas rates, not to leave them to the free play of market forces. The "just and reasonable" standard requires "meaningful rate regulation", and "presumed market forces may not comprise the principal regulatory constraint." *Farmers Union Central Exchange, Inc. v. FERC*, 734 F.2d 1486, 1507, 1530 (D.C. Cir.), *cert. denied*, 469 U.S. 1034 (1984).

The logical corollary of this point is that a price ceiling substantially *above* the prevailing market price cannot act as a meaningful restraint; at best, such a ceiling would simply allow market forces to set the ultimate rate charged. *See FERC v. Martin Exploration Management Co.*, 486 U.S. 204, 210 (1988) ("the price ceiling can only impose a direct legal restraint if the market price would be above the price ceiling"); *see also Farmers Union Central Exchange, Inc. v. FERC*, *supra*, 734 F.2d at 1507 n.47 ("ratemaking that sets charges at levels 'seldom . . . reached in actual practice' and which is 'peripheral to the pricing process' is at best a hair's breadth from total deregulation").

[3] In 1954, this Court ruled that the NGA "required the Commission to take jurisdiction over independent gas producers and to scrutinize the reasonableness of the rates they charged to interstate pipelines." *Public Service Commission v. Mid-Louisiana Gas Co.*, 463 U.S. 319, 328 (1983), citing *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672, 685 (1954).

Accordingly, under the NGA "just and reasonable" standard, the price ceilings set by the Commission must serve in reality to regulate natural gas prices. Traditionally, the Commission has accomplished this by setting price ceilings at a level generally sufficient to permit recovery of producers' actual costs plus a reasonable rate of return and depreciation. Pet. App. 2a-4a. Because the costs entailed in finding natural gas and bringing it to market have varied over time, the Commission for many years followed a practice of "vintaging," or fixing different ceiling prices for gas based on the date of the sales contract or the date on which gas was first produced. By 1978, the Commission was enforcing different ceiling prices for some 15 different vintages of gas.

B. The Natural Gas Policy Act of 1978.

From 1938 to 1978, rate regulation under the NGA applied only to the interstate natural gas market. By the 1970's, gas producers could obtain significantly higher prices in the unregulated intrastate markets, and shortages therefore developed in the interstate market. Congress enacted the Natural Gas Policy Act of 1978 primarily to address this problem. *FERC v. Martin Exploration Management Co.*, *supra*, 486 U.S. at 207.

To eliminate the dichotomy between the interstate and intrastate markets, Congress for the first time empowered the Commission to regulate wellhead prices in the intrastate markets. Pet. App. 7a. At the same time, Congress sought to alleviate existing interstate supply shortages by stimulating increased exploration and development activities for new gas supplies. *Public Service Commission v. Mid-Louisiana Gas Co.*, 463 U.S. 319, 334 (1983).

As this Court has recognized on more than one occasion, the NGPA was the product of a legislative compromise: "the Senate passed a bill deregulating interstate gas, the House passed a bill extending federal regulation to intrastate gas, [and t]he Conference Committee struck a compromise." *FERC v. Martin Exploration Management Co., supra,* 486 U.S. at 207 (citations omitted); *see also Public Service Commission v. Mid-Louisiana Gas Co., supra,* 463 U.S. at 331-332. The compromise had two parts.

In the first part, the NGPA established price ceilings, by category, for all wellhead gas sales and provided for automatic increases in these ceilings to keep pace with inflation. §§ 101-110, 15 U.S.C. §§ 3311-3320. To encourage production, the ceiling prices that Congress provided for "new" and "high cost" gas were higher than the rates that the Commission had previously established under the NGA "just and reasonable" standard. By contrast, with respect to old gas already dedicated to the interstate market, Congress maintained the existing regulated prices by incorporating into the NGPA the "just and reasonable" rates previously established by the Commission. § 104, 15 U.S.C. § 3314. As the Commission explained in its brief to this Court in the *Mid-Louisiana* case, "no incentive [was] required" for old gas because the gas already "flowed in interstate commerce prior to enactment of the NGPA . . . ." Brief for Federal Energy Regulatory Commission at 31 n.33 (Nos. 81-1889 *et al.*).

The second part of the NGPA compromise was that, for certain specified categories of gas only, Congress provided for deregulation through the complete elimination of price ceilings. § 121, 15 U.S.C. § 3331. In particular, "the price ceilings for certain 'high-cost' gas were eliminated in 1979, for certain 'old' intrastate gas and 'new' gas in 1985, and for certain other 'new' gas in 1987." *FERC v. Martin Exploration Management Co., supra,* 486 U.S. at 207.

But Congress made no provision for price decontrol of old gas, unless the old gas also qualified under another NGPA price category that expressly fell within the deregulation provisions of Section 121. *Public Service Commission v. Mid-Louisiana Gas Co., supra,* 463 U.S. at 334-335. Thus, where Congress intended for old gas to qualify for market-based pricing, Congress specifically said so in the NGPA itself.

C. The Effects of the NGPA in the Early 1980's.

As the court of appeals noted, "the effects of the NGPA were bittersweet." Pet. App. 8a. The statute did eliminate the distinctions between the interstate and intrastate markets and spurred substantial drilling activities for new gas. Some of the key market assumptions made by Congress did not materialize, however. For example, the price of oil and other competing fuels did not increase, but dropped precipitously; energy conservation was greater than expected; and pipelines began to experience problems in marketing gas purchased from producers under contracts permitting collection of NGPA ceiling prices and containing onerous "take-or-pay" provisions. *See Maryland People's Counsel v. FERC,* 761 F.2d 768, 770-771 (D.C. Cir. 1985) ("the 1978 predictions of the 1985 market were much in error. Factors ranging from the increased wellhead prices and impending total decontrol, to greater energy conservation, to the lower prices of competing fuels, have turned the natural gas shortages of the 1970's into a natural gas surplus").

The failure of the NGPA's marketing assumptions to materialize caused the Commission and the Department of Energy ("DOE") to grow increasingly dissatisfied with the congressional compromise embodied in the NGPA's pricing policies. Thus, in 1981, the Chairman of the Commission testified before a Senate Committee that "the most serious deficiency of the NGPA" was "the statute's establishment of a new *dual market*, that is, one in which some gas prices are regulated while others are

not." 51 Fed. Reg. at 22175 n.59 (emphasis in original). In 1982, the Commission issued a Notice of Inquiry proposing to increase old gas prices, but abandoned the effort due to congressional opposition. Pet. App. 9a-10a. Later, in July 1984 and January 1985, DOE filed two reports with Congress on the natural gas market, as required by NGPA Section 123, 15 U.S.C. § 3333.[4] DOE urged Congress to remove price controls over old gas and comprehensively to deregulate the natural gas market. Congress took no action in response to DOE's recommendations.

Thereafter, the Commission took matters into its own hands. Having failed to obtain what it wanted from Congress, the Commission decided to act on its own, notwithstanding the NGPA compromise.

D. Order No. 451.

In issuing Orders No. 451 and No. 451-A, the Commission sought to deregulate old gas prices. The Commission intended for those prices to be set by the market and not to be affected by any ceiling that might be set by the Commission. The Commission's own statements admit as much. The "fundamental purpose of the rule," the Commission said, "is to assure that old gas prices will more accurately reflect market clearing prices . . . ." 51 Fed. Reg. at 46781.

The Commission also admitted that it lacked the authority simply to announce that all old gas prices would henceforth be set by the market. The Department of Justice ("DOJ") urged the Commission to declare that *any price* paid for gas subject to Sections 104 and 106 of the NGPA is presumed "just and reasonable" within the meaning of the NGA. 51 Fed. Reg. at 22211. In

[4] *The First Report Required by Section 123 of the Natural Gas Policy Act of 1978* (July 1984); "Increasing Competition in the Natural Gas Market," *The Second Report Required by Section 123 of the Natural Gas Policy Act of 1978* (January 1985).

DOJ's view, "[t]he market will protect consumers from excessive rates while encouraging production of adequate supplies." *Id.* The Commission agreed that "market-based rates" were desirable, but it concluded that the DOJ proposal was "beyond its authority." *Id.* The Commission bluntly conceded that "Congress did not intend to give the Commission authority to deregulate old gas prices completely . . . ." *Id.* Then it went ahead and did just that.

And, what is worse, the Commission deregulated in a way that, by trying to preserve the appearance of a "just and reasonable" ceiling price, directly produced prices for old gas substantially higher than the market. The Commission eliminated all 15 different vintages of old gas that Congress preserved in Section 104 of the NGPA, and it decreed that the new ceiling price for all old gas would be the *highest* ceiling price then in effect for any of the old gas vintages. This price was the ceiling price for the most recent vintage of old gas, and was far above the market price in 1986, when Order No. 451 was issued. It is even farther above the market price today.[5]

The Commission's theory was that, with the ceiling price far above the market price, the market price would in fact prevail, and old gas would be effectively deregulated, or, in the Commission's jargon, "market responsive." 51 Fed. Reg. at 46781, 46792-93. By fixing the ceiling price so high that it would have no effect on trans-

[5] In June 1986, the ceiling price adopted in Order No. 451 was $2.57 per MMBtu, and the spot market price was approximately $2.00. 51 Fed. Reg. at 22176. Today, the ceiling price, having been increased monthly for inflation, is $2.95/MMBtu, 55 Fed. Reg. 18865 (1990), and the spot market price ranges from approximately $1.09 to 1.61/MMBtu. *See, e.g.*, "Weekly Gas Survey," *Gas Daily*, Eastern Division, Pasha Publications Inc. (May 7, 1990), at 1. Another natural gas industry trade publication estimated the composite spot wellhead price for the week of May 7, 1990 at $1.38/MMBtu. *See* "Gas Price Report," *Natural Gas Week*, The Oil Daily Co. (May 7, 1990).

actions in the marketplace, the Commission sought to achieve deregulation for an important category of gas that Congress had declined to deregulate in the NGPA. The Commission, and the gas producers that supported its Orders, tried to do by administrative fiat what they could not accomplish in the legislative arena.

The Commission displayed a schizophrenic attitude toward the new price ceiling that it adopted for old gas in Order No. 451. Although, as petitioners stress, the Commission repeatedly paid lip service to the statutory standard by declaring that the new price ceiling was "just and reasonable" within the meaning of the NGA, it simultaneously announced that it did not believe the new ceiling should actually be collected.

The Commission acknowledged that 85 to 90 percent of old gas contracts contained indefinite price escalation clauses (which operated automatically to fix the contract price at the new ceiling price), but at the same time the Commission said that producers with such clauses in their contracts "should not automatically receive the new ceiling price." 51 Fed. Reg. at 22204 n.242. If they did, the Commission warned, "the ceiling price would become a floor and that would distort the market as much as current artificially low ceiling prices." *Id.* at 22204; *see also id.* at 46787 and 46788 n.174 (commenting that automatic collection of the new ceiling price is not "necessarily appropriate" and not "necessarily just and reasonable"). Indeed, the Commission admitted that automatic escalation to the ceiling price "*would not be a just and reasonable result in the sense of providing for the lowest reasonable rate under NGA section 5(a).*" *Id.* at 46788 (emphasis added).

In a cosmetic attempt to address the problems that it itself identified, the Commission established the so-called "good faith negotiation" ("GFN") procedures. These procedures allegedly were designed "to assure that old gas prices are paid at the current market price or the ceiling

price, *whichever is lower* . . . ." 51 Fed. Reg. at 22190 (emphasis in original). In fact, as even the most cursory examination shows, the GFN procedures are a sham and cannot possibly achieve their stated purpose.

Although labelled a "negotiation procedure" and embellished with an elaborate series of negotiating steps (*see* 18 C.F.R. § 270.201 (1989), reprinted in the appendix to the producers' petition, 89-1452 Pet. App. 62a-69a), the GFN process in reality is extremely one-sided, as the court of appeals found. Pet. App. 31a-32a. Only producers can initiate the GFN process. 51 Fed. Reg. at 46789-90. To do so, a producer that is a party to a contract to sell old gas asks the purchaser to "nominate" a price at which the purchaser is willing to continue buying the old gas. If the purchaser "nominates" any price less than the new ceiling price, the producer has the unilateral right to terminate the contract, find a new purchaser for the gas, and obtain automatic abandonment of the sales obligation to the prior purchaser—all with no oversight or review by the Commission under the Natural Gas Act. 51 Fed. Reg. at 22204-05, 46785-86, and 46788.

Order No. 451 makes contract termination an attractive option to producers. For example, contract termination entitles the producer to automatic abandonment of its sales service obligation to the former pipeline purchaser with no prior Commission review or approval under NGA Section 7(b), 15 U.S.C. § 717f(b). It also entitles the producer to a "blanket" sales certificate under Section 7(c) of the NGA, 15 U.S.C. § 717f(c). This relieves the producer from the obligation of obtaining further certificates of public convenience and necessity from the Commission for all subsequent resales of the gas to the interstate market. 51 Fed. Reg. at 22213-14. In addition, the Commission established a "mandatory transportation certificate" procedure that requires prior pipeline purchasers of old gas to transport to new purchasers the very gas "released" by contract termination, *i.e.*, the very gas that the producer has refused to continue selling to

the pipeline because the pipeline has not agreed to pay the new ceiling price set under Order No. 451.[6]

E. The Natural Gas Wellhead Decontrol Act of 1989.

In 1989, three years after the Commission deregulated old gas in Order No. 451, Congress decided to change the pricing policies embodied in the NGPA and to end by no later than January 1, 1993 all federal price regulation of wellhead sales of natural gas. Congress accomplished this by enacting the Natural Gas Wellhead Decontrol Act of 1989, Pub. L. No. 101-60, 103 Stat. 157. Congress thus took the step it had deliberately refused to take in 1978 when it enacted the NGPA: it deregulated old gas.

Under the new statute, price controls on all gas, including all old gas, will be eliminated entirely on January 1, 1993. Private parties, however, can "deregulate" old gas at any time after July 26, 1989, through private negotiation. Such negotiation can occur at any time an existing gas purchase contract expires or is terminated or modified. *See* Section 2(a) of the Act, 103 Stat. 157.

Congress devised procedures permitting deregulation by private negotiation before January 1, 1993 to assist the industry in its transition from NGPA pricing policies to full deregulation of wellhead sales and thus to smooth out the market effects of that transition. The Commission recently adopted final rules to help implement the Wellhead Decontrol Act's transition procedures (*see* 55 Fed. Reg. 17425 (1990)), and producers (including some of the petitioners in this case) already are using these procedures to achieve deregulation in the manner Congress intended.[7]

[6] Since Order No. 451 became effective, most pipelines have become "open access" pipelines. The mandatory transportation certificate procedure therefore is of little practical significance, and petitioners do not seek review of the court of appeals' decision invalidating this procedure.

[7] *See, e.g.*, the excerpt from Securities and Exchange Commission Form 10-K filed in March 1990 on behalf of petitioner Anadarko Petroleum Company, reproduced in Appendix B to this brief.

F. The Impact of Order No. 451.

To put it mildly, the effect of Order No. 451 has been very different from what the Commission claims to have expected when it issued the order. Although the Commission repeatedly touted its action as a measure to benefit consumers (*see, e.g.*, 51 Fed. Reg. at 22195), in fact Order No. 451 has done nothing of the kind. As a result of the order, consumers have been subjected to significant increases in the price of old gas. Between March 1986 and January 1989, the price of old gas increased by 44%, or more than 14 percent annually.[8] This increase has far outstripped the rate of inflation, even though Congress, in the NGPA, expressly indicated its intention that old gas prices generally should be permitted to rise no faster than inflation. During the period from March 1986 to January 1989, inflation was below 4 percent annually.[9]

A study prepared by the Interstate Natural Gas Association of America confirms the fact that Order No. 451 has not helped consumers. The study showed that operation of Order No. 451's GFN procedures resulted in a net gas cost increase of approximately $215 million in 1988 alone.[10]

Significantly, *all* of the old gas covered by Section 104 of the NGPA and now subject to the above-market ceiling price was already in production and dedicated for sale to consumers served by the interstate market before Order No. 451 was issued. Accordingly, there was no basis for the Commission's claim that Order No. 451

[8] *Gas Costs, Resale and Transportation Rates of Pipeline Companies—A Monthly Service*, Foster Associates Inc. (January 25, 1989), Summary Table 4.

[9] Council of Economic Advisors, *Economic Indicators*, "Implicit Price Deflator for Gross National Product" (March 1990).

[10] Interstate Natural Gas Association of America, *The Washington Report*, No. 1450, at 9 (September 29, 1989).

was essential to avoid premature abandonment of low-cost gas supplies. *None* of the interstate sales could have been abandoned unless the Commission affirmatively authorized abandonments pursuant to Section 7(b) of the NGA.

Moreover, to the extent the existing regulated prices might have been thought inadequate and likely to lead in some cases to premature abandonment of old gas, the Commission could have set new ceiling prices targeted to that incremental production. This would have achieved the stated goals of Order No. 451 without the exorbitant cost increases that the Order has imposed on consumers. And, in light of the Wellhead Decontrol Act, even such a more limited measure would have been unnecessary. This is because the Commission itself announced that the majority of the abandonment decisions that it hoped to avoid would not be made until the 1990's. 51 Fed. Reg. at 46775. By that time, the Wellhead Decontrol Act would have provided all the assurance of pricing flexibility that any producer could possibly have needed.

G. The Court of Appeals' Decision.

After the Commission issued its order on rehearing (Order No. 451-A), the gas producers identified a minor aspect of the Commission's action with which they were dissatisfied and sought review in the Fifth Circuit. Respondents sought review in the D.C. Circuit, but their petitions were transferred to the Fifth Circuit, where the producers had already filed.

The court of appeals ruled that Orders No. 451 and No. 451-A exceeded the authority conferred on the Commission by Congress. The court therefore vacated the orders in their entirety. Pet. App. 36a. In the court's view, the Commission "ignored congressional intent and exceeded its authority by allowing for de facto deregulation of old gas." *Id.* at 17a. By maintaining the NGA "just and reasonable" standard for old gas, the court held, Congress intended to maintain regulation and lower prices for old gas and not to permit the price of such gas to be set by the market, with or without an above-market ceiling price. *Id.* at 20a-23a.

Likewise, the court ruled that the Commission "abdicated its responsibility under Section 7(b) of the NGA by providing for an across-the-board, pre-authorized abandonment" of producers' existing service obligations, as part of the GFN procedures adopted in Order No. 451. Pet. App. 28a. Under these procedures, producers may unilaterally terminate their existing old gas contracts whenever a purchaser will not agree to pay the Commission's new above-market ceiling price. The court held that, by deciding in advance to allow, in *every* such situation, abandonment of the very service obligations that the Commission itself has certified as promoting the "public convenience and necessity," the Commission disregarded its proper statutory role. The court relied in part on this Court's decision in *United Gas Pipe Line Co. v. McCombs*, 442 U.S. 529 (1979), which refused to approve a producer's *de facto* control of the abandonment process.

The court of appeals also found it "regrettable and unwarranted" that the Commission chose to issue Order No. 451 without addressing the so-called "take-or-pay" problem. Pet. App. 31a. As the court explained, natural gas markets have suffered serious adverse effects from contracts reached in the 1970's that require purchasers to pay for large quantities of natural gas whether they take that gas or not. *Id.* at 29a-30a. Although the court of appeals did not direct the Commission to take any particular action with respect to the take-or-pay problem, it did find "arbitrary and unsupportable" the Commission's stated rationale for omitting the subject from

Order No. 451. Pet. App. 32a. This was particularly so, the court said, in light of the "one-sided nature of the GFN process," which empowers gas producers to terminate old gas contracts whenever purchasers will not agree to pay the Commission's new above-market ceiling price. *Id.* at 31a.

Judge Brown dissented. Pet. App. 36a-60a. He disagreed with virtually everything the majority said. In particular, he believed that the Commission's authority under the NGPA is broad enough to allow the Commission to adopt a substantially above-market ceiling price and thus effectively to deregulate the price of old gas. *Id.* at 47a-50a. Judge Brown also thought that the Commission's pre-granted abandonment—which he found to be "at the heart of the goals of Order No. 451"—was consistent with the requirements of Section 7(b) of the NGA. *Id.* at 52a-55a.

The Commission and the producers petitioned for rehearing and suggested rehearing en banc. The court of appeals denied the petition, and no judge of the court called for a vote on the suggestion of rehearing en banc. Pet. App. 62a.

ARGUMENT

Review by this Court is not warranted. The court of appeals' decision is correct, and the statutory provisions involved have been repealed. There is no conflict among the circuits, and no conflict can arise in the future. By January 1, 1993, the Wellhead Decontrol Act will eliminate all price regulation for wellhead sales of natural gas. Under the transition procedures established in that Act, the shift to deregulation has already begun. On January 1, 1993, the repeal of Title I of the NGPA, including Sections 104 and 106, will become effective, and the Commission will have no further authority to issue price ceiling orders under the NGPA. Its deregulation objectives will be accomplished by statute in the manner prescribed by Congress. The court of appeals' decision therefore lacks any long-term significance.

Moreover, review of the court of appeals' ruling is not needed to preserve any benefits for consumers. As we have already shown (see pages 13-14, *supra*), Order No. 451 has created significantly higher prices for old gas. The Order has benefited only gas producers, not users of natural gas, as the alignment of parties here plainly shows.[11]

Petitioners' prophecies of market disruption in the event the court of appeals' ruling is left undisturbed are not persuasive. In the first place, the premise that any such disruption will occur is problematical at best. The government and the producers present widely divergent estimates of the number of contracts that have been renegotiated under Order No. 451 (*contrast* 89-1452 Pet. 3, 13, 26-27 *with* 89-1453 Pet. 16), and they do so without any citation and without any indication of what percentage of currently flowing gas is covered by the contracts involved.

More important, Order No. 451 has been under attack from the outset, and all affected participants in the industry have been aware of the Order's doubtful legal

[11] In addition to the petitioner gas producers, three so-called "industrial user groups," respondents in this Court, also support the Commission's Orders. These groups, which consist of large industrial consumers of natural gas such as steel and aluminum companies and glass manufacturers, support Order No. 451 because the Order allows low-cost old gas supplies to be diverted from the interstate market and made available for direct sale to, and consumption by, large industrial users. The participation of such users here demonstrates that the effect of the Commission's action has been to transfer much of the economic benefit of old gas from the interstate market generally (including residential users) to a single favored segment of manufacturers. Thus, an Order that the Commission has attempted to defend as a measure to rationalize the natural gas market has in fact promoted concentration of the economic benefits of old gas in the hands of a relatively few large corporate users whose superior economic bargaining power has enabled them to capture old gas supplies that properly should serve the nation as a whole.

status. The producers should not be heard to complain now if they failed to plan for the possibility that the Order would be vacated. *See, e.g., Callery Properties, Inc. v. FPC*, 335 F.2d 1004, 1018 (5th Cir. 1964) (holding in a comparable situation some years earlier that "[t]he risk inherent in making deliveries pending final judicial determination was obvious to the producers"), *rev'd on other grounds*, 382 U.S. 223 (1965).

Several respondents, in fact, moved for a stay of the Order's effectiveness pending judicial review. The Commission denied that relief, saying that any problems that the Order might create could be rectified through "money adjustments" if the Order were invalidated. 51 Fed. Reg. at 46817 n.388 (1986). Similarly, when one of the respondents (supported by several others) asked the Eighth Circuit to stay the Commission's action, the court declined, basing its decision on a finding that "the normal administrative and judicial review processes will adequately protect [respondent's] interests, and are capable of providing [respondent] any relief to which it may ultimately be entitled." *In re KN Energy, Inc.*, No. 86-1806 (8th Cir. 1986), reprinted as Appendix C, *infra*, at 16a.

Against this background, petitioners cannot convincingly claim that review by this Court is needed to avoid the practical problems that Order No. 451's invalidation allegedly will cause. The private negotiation procedure established by Congress in the Wellhead Decontrol Act is available to ameliorate any difficulties that may arise in connection with contracts that have been renegotiated under Order No. 451, and indeed some of the producer-petitioners already have begun to use these procedures (*see* page 12 and n.7, *supra*). If Order No. 451 were to continue in effect, it would only serve to frustrate and impede the transitional process that Congress created.[12]

[12] Producers, of course, have a strong incentive to prefer the Order No. 451 "negotiating" process over the negotiating process Congress created in the Wellhead Decontrol Act. The "negotiating" procedures of Order No. 451, as the court of appeals found, are one-sided and overwhelmingly favor producers.

In any event, it really is no argument to say that the Commission has made a blunder so large that no court should be allowed to correct it. Here, the Commission issued orders, with the full support and encouragement of the producers, that were a conscious attempt to circumvent the congressional decision in the NGPA to retain meaningful price regulation for old gas. Having affirmatively sought the Commission's action, the producers properly can be asked to bear the burdens of undoing it. As the court of appeals recognized, an agency's deliberate departure from a statutory command should be overturned, even if some economic disruption is caused. Pet. App. 36a.

On the merits, the court of appeals reached the only result consistent with the statutory compromise in the NGPA. The "just and reasonable" standard that Congress borrowed from the NGA and incorporated into the NGPA was familiar statutory language that carried with it a regulatory scheme well-known to Congress, the Commission, and the industry. When Congress provided, in Sections 104(b)(2) and 106(c) of the NGPA, that the Commission's power to prescribe new maximum ceiling prices for old gas was limited by the NGA "just and reasonable" standard, Congress evidenced its intention *not* to deregulate old gas prices, directly or indirectly. The Commission's stratagem of fixing a ceiling price far above the market price in an effort to allow the market to determine old gas prices cannot be squared with Congress' undisputed intent to continue price regulation for old gas.

As early as 1974, four years before Congress enacted the NGPA, this Court held in *FPC v. Texaco, Inc., supra*, 417 U.S. at 397, that "the prevailing price in the market place cannot be the final measure of 'just and reason-

able' rates mandated by the [NGA]." Congress retained the "just and reasonable" standard for old gas prices against the background of that ruling. The Commission itself admitted in Order No. 451 that it lacked authority simply to declare all prices just and reasonable and let the market govern. 51 Fed. Reg. at 22211. The court of appeals properly concluded that Order No. 451 was not materially different from what the Commission acknowledged it could not do and that the Order therefore was unlawful.

The court of appeals' ruling was thus based not only on the text of Sections 104(b)(2) and 106(c) but also on the structure of the NGPA compromise, the place of old gas regulation within that structure, and the contrast between Congress' treatment of old gas and its treatment of the various categories of gas that it did decide to deregulate. The legislative history cited by the court of appeals merely confirmed the conclusion that the court drew from the face of the statute itself. Although petitioners now attempt to characterize that legislative history as nothing more than "isolated statements by individual legislators" (89-1452 Pet. 14; *see also* 89-1453 Pet. 12), the Commission cited much of the same legislative history to this Court in *Mid-Louisiana*, when it was in the Commission's interest to explain why Congress chose to treat old gas as it did in the NGPA. Brief for the Federal Energy Regulatory Commission at 31-32 (Nos. 81-1889 *et al.*).

Petitioners' reliance on *Chevron U.S.A. Inc. v. NRDC, Inc.*, 467 U.S. 837 (1984), is misplaced. Congress has "directly spoken to the precise question at issue here"—twice. In 1978, in the NGPA, Congress decided that old gas prices should not be decontrolled; in 1989, in the Wellhead Decontrol Act, Congress decided that they should be. The Commission was not free to change Congress' decision in the meantime. Certainly, nothing in *Chevron* gave the Commission that authority, which perhaps explains why none of the petitioners saw fit even to cite *Chevron* in their briefs in the court of appeals.

I. THE COURT OF APPEALS CORRECTLY REJECTED THE COMMISSION'S *DE FACTO* DEREGULATION OF OLD GAS.

The court of appeals did not hold, as petitioners contend, that "the Commission is without authority under Sections 104(b)(2) and 106(c) to increase prices of old gas . . . ." 89-1453 Pet. 15. On the contrary, the court expressly stated that "sections 104(b)(2) and 106(c) *do* vest the Commission with the authority to raise the NGPA's ceiling prices in accordance with the "just and reasonable" standards of the NGA . . . ." Pet. App. 22a (emphasis added). The court added, however, that "this authority does not translate into unfettered discretion." *Id.*

Similarly, the court of appeals' decision does not depend primarily on the elimination of vintaging, as petitioners try to suggest (89-1453 Pet. 15; 89-1452 Pet. 14). Rather, the court of appeals focused its attention on precisely the right issue: whether Order No. 451's new ceiling price comports with the "just and reasonable" standard that Congress incorporated into the NGPA for old gas.

The court held that it does not, relying on the Commission's own statements (Pet. App. 11a-13a and n.15):

1. that the so-called "replacement cost" methodology purportedly used to set the new ceiling price was intended to reflect the "prices [that] would be established if deregulation of old gas were to occur" (51 Fed. Reg. at 22187);
2. that the Commission had never before used a replacement cost methodology to fix the ceiling price of old gas;
3. that the Order No. 451 ceiling price greatly exceeded the competitive market price;

4. that actual collection of the new ceiling price "would yield unjust and unreasonable prices" (Pet. App. 13a); and
5. that the Commission was depending on market forces to "reduce the actual price paid for old gas to levels consistent with the NGA's consumer protection mandate" (Pet. App. 11a).

Taking the Commission at its word on these points, the court concluded that Order No. 451 was intended to operate, and in fact would operate, to deregulate old gas and that it therefore exceeded the Commission's authority under the NGPA. Pet. App. 17a.[13]

Both petitions try to evade the real basis for the court's decision by burying it in a footnote (89-1453 Pet. at 22 n.9; 89-1452 Pet. at 19 n.11). But this tactic cannot change the court's reasoning. The court addressed what the Commission actually did, not the Commission's self-serving assurances that everything was "just and reasonable." Moreover, by holding that the Commission's deregulation was inconsistent with the regulatory standard incorporated in the NGPA, the court necessarily found that Order No. 451 was not "just and reasonable" within the meaning of the NGPA. Petitioners' attempt to pretend that the court left intact the Commission's purported "just and reasonable" findings (*see* 89-1453 Pet. 11, 17; 89-1452 Pet. 13) cannot survive comparison with what the court actually held.

[13] The court's conclusion about the Commission's *de facto* deregulation of old gas would have been justified by Order No. 451's ceiling price provision alone. When one also considers the pre-granted abandonment and blanket certificate procedures, and the elimination of all rate filing requirements for gas that has been "released" under the GFN procedures, 51 Fed. Reg. at 22209-22210, there can be no doubt of the deregulatory purpose and effect of the Commission's action. By virtue of Order No. 451, producers of old gas can escape *every* aspect of NGA jurisdiction, in direct contravention of the plain language of the NGPA. *See* Sections 104, 106, and 601(a), 15 U.S.C. §§ 3314, 3316, and 3431(a).

This Court's most recent decision involving the NGPA, *FERC v. Martin Exploration Management Co.*, 486 U.S. 204 (1988), provides strong support for the court of appeals' decision. *Martin* concerned the proper interpretation of Section 101(b)(5) of the NGPA, 15 U.S.C. § 3311(b), which deals with gas that "qualifies under more than one provision . . . providing for any maximum lawful price or for any exemption from such a price . . . ." In such situations, Section 101(b)(5) makes applicable "the provision which could result in the highest price . . . ."

The controversy in the case arose because many producers who had gas that qualified for both regulation and deregulation also had long-term contracts that priced regulated gas at or near the applicable price ceiling and deregulated gas on the basis of either the market price or renegotiation between the parties. In the 1980's, when the market price dropped substantially below the NGPA price ceilings, producers with gas that qualified as both regulated and deregulated argued that Section 101(b)(5) permitted them to treat the gas as regulated and thus to obtain the higher price that regulated gas would bring under their contracts.

The Commission, however, promulgated a regulation that interpreted Section 101(b)(5) to mean that "any gas that was qualified for both deregulated and regulated treatment would be treated as deregulated." 486 U.S. at 208. Numerous producers attacked the regulation as an incorrect interpretation of the statute. This Court upheld the Commission's position. *Id.* at 209-211.

The Court explained that the producers' reading of Section 101(b)(5) would have the effect of "turning a statutory scheme of price ceilings and deregulation into a system of price supports for producers." 486 U.S. at 210. The Court ruled that Congress did not intend "to create such a producer-assistance program." *Id.* Congress' "operating assumption", in the Court's view, was

that "deregulation was the most favorable regime for gas producers . . . ." *Id.* at 211. In fact, the Court said, "[n]ot one participant in the legislative process suggested that producers should receive higher prices than deregulation would afford them." *Id.* at 210.

Order No. 451 achieves for *regulated* low-cost old gas essentially the same "system of price supports for producers" that this Court rejected for *deregulated* gas in *Martin.* The Order allows producers to demand that purchasers with existing contracts pay the above-market ceiling price for old gas. If the purchasers agree (which many of them have, for a variety of different economic reasons), the producer obtains the above-market price. If the purchasers refuse, the producer is authorized to terminate the contract and sell the gas to another purchaser at the prevailing market price. The producer thus gets either the market price or the higher ceiling price fixed under Order No. 451. This is precisely the kind of "better than deregulated" position that the Court rejected in *Martin.* The court of appeals' decision invalidating Order No. 451 thus accords with this Court's prior rulings and presents no novel issue warranting further review.

The mere fact that the Commission included some ceiling price in Order No. 451 does not mean that the Order comports with the NGPA requirement that the ceiling price be "just and reasonable." A ceiling price of $100 a pound obviously imposes no regulatory constraint on the price of apples. Similarly, the ceiling price adopted in Order No. 451 is far above the market price and does not impose a regulatory constraint on the price of old gas. That is why the Department of Energy ("DOE") recently has confirmed that under Order No. 451 old gas is "effectively decontrolled." DOE's Energy Information Administration chose that phrase to refer to gas categories for which the price ceiling has been set well above the market price—exactly what the Commission did in

Order No. 451. *See* J. Tobin and W. Trapman, *Natural Gas Wellhead Decontrol Act of 1989*, Natural Gas Monthly (Nov. 1989), at 8-10 and n.12. This effective deregulation is not what Congress had in mind when it incorporated the "just and reasonable" rate standard in the NGPA. In fact, as we have shown, the regime created by Order No. 451 has frequently resulted in above-market prices for producers, thus granting the producers even more than they would have received under actual deregulation. The Court condemned this kind of windfall in *Martin*, and it was correctly repudiated by the court of appeals here as well.

II. THE COURT OF APPEALS CORRECTLY HELD THAT THE COMMISSION'S PRE-GRANTED ABANDONMENT VIOLATED SECTION 7(b) OF THE NATURAL GAS ACT.

The court of appeals did not err, as petitioners claim, in rejecting the automatic abandonment procedures created by Order No. 451. The court properly relied on the clear language of NGA Section 7(b), and it reached its decision only after it considered and evaluated the intended operation of the GFN process. The court then found that the "pre-grant of abandonment runs contrary to the instruction of [this Court] in *United Gas Pipeline Co. v. McCombs,*" 442 U.S. 529 (1979), largely because "[t]he absence of provisions for factual inquiry into the circumstances of an abandonment allows for the 'abandonment determination [to] rest, as a practical matter, in the producer's control . . . .'" Pet. App. 27a, 28a, quoting *McCombs, supra*, 441 U.S. at 539. The court observed that the natural consequence of an abandonment procedure that is "altogether in the producer's control" and that can be "implemented only at the behest of the producer" is that the procedure will be used "only when such utilization would serve the producer's economic

interest." Pet. App. 28a. This was the very result that the Court found unacceptable in *McCombs*.[14]

There is no merit to petitioners' claim that the Commission satisfied the Section 7(b) hearing requirement through the "hearing" held in connection with the Order No. 451 rulemaking proceedings. Congress' decision to require "due hearing" prior to any abandonment of federally regulated gas sales service imposed an affirmative regulatory responsibility on the Commission. The Commission cannot meet that responsibility simply by surrendering it to one group of parties (*e.g.*, producers) whose actions are guided by economic self-interest. Congress intended the Commission to protect the public interest, not merely to declare victory and leave the arena.

That is why this Court made clear in *McCombs* that the "due hearing" required in Section 7(b) "permits all interested parties to be heard and therefore facilitates full presentation of the facts necessary to determine whether § 7(b)'s criteria have been met." 442 U.S. at 538. The hearing must not deal with only "a hypothetical set of facts . . . ." *Id.* at 540. But the Commission's alleged consideration of the public interest and its decision *always* to pre-grant abandonment for sales of old gas occurred before Order No. 451 even became effective and thus well before *any* concrete proposal for abandonment was presented. The Order No. 451 "hearing", therefore, did not provide, and could not have provided, opposing parties with a meaningful opportunity to be heard.

[14] Neither petition seriously contests the court of appeals' finding that the GFN process effectively vested control of abandonments in the hands of the producer. Moreover, Order No. 451 has not worked, as the Commission promised, to produce the *lower* of the market or ceiling price. In some instances, pipelines have offered the producer a market price, only to have the producer exercise contract termination rights under the GFN procedures and abandon service over the pipeline's objection. *See, e.g.*, the exchange of correspondence between petitioner Mobil Natural Gas, Inc. and respondent Williams Natural Gas Co., reproduced in Appendix D, *infra*.

The court of appeals' holding also is consistent with this Court's decision in *FPC v. Moss*, 424 U.S. 494 (1976). The pre-granted abandonment procedure approved in *Moss* merely allowed a producer to submit an NGA certificate application for a specific transaction and, *at the same time*, to seek and provide justification for pre-granted abandonment. *See id.* at 498. But the *Moss* pre-granted abandonment procedure was not automatic; it could be "exercised only upon appropriate findings by the [Federal Power Commission] of public convenience or necessity . . . ." *Id.* at 498-499. Thus, unlike Order No. 451, the *Moss* pre-granted abandonment procedure required the Commission actually to make findings on specific transactions and to provide affected parties with the right to an individual hearing, where appropriate.

Petitioners are clearly wrong in asserting that the court of appeals' holding on the abandonment issue conflicts with the decisions in *Associated Gas Distributors v. FERC*, 824 F.2d 981 (D.C. Cir. 1987), *cert. denied*, 485 U.S. 1006 (1988), and *Kansas Power & Light Company v. FERC*, 851 F.2d 1479 (D.C. Cir. 1988). In *Associated Gas Distributors*, the D.C. Circuit approved a pre-granted abandonment procedure in situations where the *purchaser* elected to reduce service, thereby agreeing to the abandonment. In contrast, the plain terms of Order No. 451 allow abandonment over the *objection* of the purchaser. In *Kansas Power & Light*, the Commission provided an opportunity to challenge the proposed abandonments based on the specific proposals set forth in the abandonment applications. 851 F.2d at 1482-1483. Neither case presented the abandonment issue raised by Order No. 451: whether abandonment of service can be permitted without any "due hearing" or any examination of the facts and circumstances of a particular proposal.

The court of appeals' decision on the abandonment issue is correct and does not warrant review here.

III. THE COURT OF APPEALS' COMMENTS ON THE TAKE-OR-PAY ISSUE WERE PROPER AND DO NOT PRESENT ANY QUESTION SUITABLE FOR REVIEW.

Petitioners' position on the take-or-pay issue fundamentally misstates the holding of the court of appeals. Contrary to their claim (89-1453 Pet. 25-26; 89-1452 Pet. 23-26), the court of appeals did not require the Commission to "resolve" the take-or-pay problem. Having already ruled that Order No. 451 was invalid because of its pricing and abandonment provisions, the court merely said that the Commission's failure to address the take-or-pay problem was "regrettable and unwarranted." Pet. App. 31a. The court also expressed its view that the Commission's rationale for its inaction was "arbitrary and unsupportable." *Id.* at 32a. But the court did not direct the Commission to do anything, and petitioners' attempt to create a contrary impression is not supported by the court's opinion.

The court of appeals' dissatisfaction with the Commission's "head in the sand" attitude toward the take-or-pay problem was entirely justified. The Commission declared in Order No. 451 that the competitive market would, in some undisclosed way, resolve the problem of high-cost, take-or-pay contracts. 51 Fed. Reg. at 22183. As the court observed, however, this sort of wishful thinking had already been rejected by the D.C. Circuit in *Associated Gas Distributors*, *supra*, 824 F.2d at 1023, "because it failed to effectively address the take or pay problem." Pet. App. 30a. The court of appeals here simply noted its agreement with the holding in *Associated Gas Distributors.*

The court of appeals also found that, because of the one-sided nature of the GFN process, producers would not initiate that process "if by so doing, they ran the risk of giving up more on new gas contracts than they would receive in return for their old gas." Pet. App. 32a.

For this reason, the court concluded that "the prospect for exacerbating the take or pay problem runs rampant throughout the provisions of Order No. 451." *Id.*

Petitioners do not dispute the court's assessment of the likely effect of Order No. 451. Instead, they seek to deflect this Court's attention from what the court of appeals actually said by arguing that an agency "has exceedingly broad discretion to determine the proper ordering of its regulatory priorities . . . ." 89-1453 Pet. 25; *see also* 89-1452 Pet. 24. The argument misses the point. The court of appeals found that Order No. 451 itself, particularly the GFN procedures, would exacerbate the take-or-pay problem. The court commented not on the Commission's "ordering of its regulatory priorities," but on the reasonableness of the action taken in Order No. 451.

In any event, the important consideration here is that the court of appeals did not order the Commission to do anything with respect to the take-or-pay issue, and this portion of the court's opinion therefore presents no practical question suitable for this Court's review. This Court does not grant certiorari merely to evaluate the wisdom of statements in court of appeals opinions.

CONCLUSION

The petitions for a writ of certiorari should be denied.

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APPENDICES

APPENDIX A

LIST OF RESPONDENTS AND RESPONDENTS' PUBLICLY TRADED PARENTS AND SUBSIDIARIES

AMERICAN PUBLIC GAS ASSOCIATION ("APGA")

ASSOCIATED GAS DISTRIBUTORS ("AGD")

AGD member companies:

Atlanta Gas Light Company

Subsidiaries:

Georgia Gas Company
Georgia Engine Sales & Service
Trustees Investments, Inc.
Georgia Natural Gas Company
Georgia Gas Service Company
Georgia Energy Company

Baltimore Gas & Electric Company

Subsidiaries:

BNG, Inc.
Constellation Holdings, Inc.

Constellation Development, Inc.
Constellation Investments, Inc.
Constellation Operating Services, Inc.
Constellation Real Estate Group, Inc.
Constellation Water Systems, Inc.

Affiliate:

Safe Harbor Water Power Corporation

Bay State Gas Company

Subsidiaries:

Bay State Exploration, Inc.
Bay State Gas Supply, Inc.

Northern Utilities, Inc.
Granite State Gas Transmission, Inc.

The Berkshire Gas Company
Boston Gas Company

Parent: Eastern Gas and Fuel Associates

The Brooklyn Union Gas Company

Subsidiaries:

Fuel Resources, Inc.
Fuel Resources Gathering, Inc.
Brooklyn Union Exploration Company, Inc.
Gas Energy, Inc.
Methane Development Corporation
Collectaccount Services, Inc.
Star Enterprises, Inc.
Delaware Valley Propane Company

Central Hudson Gas & Electric Corporation

Subsidiaries:

Central Hudson Enterprises Corp.
Central Hudson Cogeneration, Inc.
CH Resources, Inc.
Greene Point Development Corp.
Phoenix Development Co., Inc.

Chesapeake Utilities Corporation

Subsidiaries:

Central Florida Gas Co.
Eastern Shore Natural Gas Co.
Dover Exploration Co.

Skipjack, Inc.
Sharpgas, Inc.

City of Holyoke, Mass., Gas & Electric Department
City of Norwich, Department of Public Utilities
City of Westfield Gas & Electric Light Department

Colonial Gas Company

Subsidiary: Transgas, Inc.

Commonwealth Gas Co.

Parent: Commonwealth Energy System

Concord Natural Gas Corporation

Subsidiary: Concord Gas Service Corp.

Consolidated Edison Company of New York, Inc.
Delmarva Power & Light Company

Subsidiaries:

Delmarva Energy Company
Delmarva Industries, Inc.
Delmarva Capital Investments, Inc.

DCI I, Inc.
DCI II, Inc.

Elizabethtown Gas Company

Parent: NUI Corporation

EnergyNorth, Inc.

Subsidiaries:

EnergyNorth Realty, Inc.
Gas Service, Inc.

Energy Resources Corp.

Manchester Gas Co.
Concord Natural Gas Corp.
Concord Gas Service Corp.
Rent-A-Space of New England, Inc.

Essex County Gas Company
Fitchburg Gas & Electric Light Company

Subsidiary: Fitchburg Energy Development Co.

New Jersey Natural Gas Company

Parent: New Jersey Resources Corporation

North Carolina Natural Gas Corporation

Subsidiaries:

NCNG Exploration Corp.
Cape Fear Energy Corp.

Northern Utilities, Inc. (see Bay State Gas Company)
Pennsylvania Gas & Water Company

Parent: Pennsylvania Enterprises, Inc.

Pequot Gas Co.
Philadelphia Electric Company

Subsidiaries:

Adwin Equipment Company
Adwin Realty Company
Conowingo Power Company
Eastern Pennsylvania Development Company
Eastern Pennsylvania Exploration Company
Philadelphia Electric Power Company
The Susquehanna Electric Company
The Susquehanna Power Company

Philadelphia Gas Works
Providence Gas Company

Parent: Providence Energy Corporation

Public Service Company of North Carolina, Inc.

Subsidiaries:

PSNC Natural Resources Corporation

Tar Heel Energy Corp.
PSNC Production Corp.
PSNC Exploration Corp.
PSNC Propane Corp.

Public Service Electric & Gas Company

Subsidiaries:

Energy Pipeline Corporation
Energy Terminal Services Corporation

Mulberry Street Urban Renewal Corporation
PSE&G Overseas Finance N.V.
PSE&G Research Corporation
Public Services Resources Corp.
Community Energy Alternatives, Inc.
Energy Development Corporation

Gasdel Pipeline System, Inc.

South County Gas Co.
South Jersey Gas Co.

Parent: South Jersey Industries, Inc.

The Southern Connecticut Gas Co.

Parent: Connecticut Energy Corp.

UGI Corporation

Subsidiaries:

AmeriGas, Inc.

AP Propane
AmeriGas II, Inc.
Schwartz Carbonic Company
Industrial Gases, Inc.
Picar, Inc.
AmeriLease, Inc.
ANSUTECH, Inc.
Matheson Gas Products, Inc.
Matheson Gas Products Canada, Inc.

UGI Development Company

Ashtola Production Company
International Petroleum Service Company

Keystone Oilfield Supply Co.
Stimwell Services Company
B&L Services Company

Universal Well Services, Inc.

Target Cementing Co.
UGID Holding Company

Triad Drilling Company
Union Supply Company
Wellhead Compressor Packagers Company
Wellhead Finance Co.

Cryotex, Inc.
Heavy Media, Inc.
Four Flags Drilling Company, Inc.

Tri-Four, Inc.

UGID Drilling Company
UGID Drilling Investing Company
UGI Ethanol Development Corporation
SAM's Well Service, Inc.
Development Leasing Corporation
Physicians Technology Corporation
Capital Housing, Inc.
Skyten Corporation
UGI Realty Company
UGI Finance N.V.

Valley Gas Co.

Parent: Valley Resources, Inc.

Washington Gas Light Co.

Subsidiaries:

Crab Run Gas Co.
Davenport Insulation, Inc.
Frederick Gas Co., Inc.
Hampshire Gas Co.
Shenandoah Gas Co.
Brandywood Estates, Inc.

Washington Gas Approved Services, Inc.

Rock Creek Properties, Inc.
Utilitrol

Yankee Gas Services Company

CITIZEN ACTION

Citizen Action is a group of 2 million citizens. None of the members of Citizen Action are corporations or other privately held entities with publicly-traded stocks.

ELIZABETHTOWN GAS COMPANY

Parent: NUI Corporation

THE KANSAS POWER AND LIGHT COMPANY

KN ENERGY, INC.

LACLEDE GAS COMPANY

MARYLAND PEOPLE'S COUNSEL

Maryland People's Counsel ("MPC") is the statutory representative of residential and other noncommercial users of regulated public utility service, including natural gas, in the State of Maryland.

STATE OF MICHIGAN

MICHIGAN PUBLIC SERVICE COMMISSION

MIDWEST ENERGY, INC.

THE MINNESOTA DEPARTMENT OF PUBLIC SERVICE

MISSOURI PUBLIC SERVICE COMMISSION

NATIONAL ASSOCIATION OF STATE UTILITY CONSUMER ADVOCATES ("NASUCA")

Members of NASUCA are the official state representatives of residential, and in some instances, commercial, consumers of natural gas in 41 states.

NORTH SHORE GAS COMPANY

Parent: Peoples Energy Corporation

OHIO OFFICE OF CONSUMERS' COUNSEL

Ohio Office of Consumers' Counsel is the statutory representative of residential and other noncommercial users of regulated public utility service, including natural gas, in the State of Ohio.

PACIFIC GAS AND ELECTRIC COMPANY

Subsidiaries or affiliates:

Alberta Natural Gas Company Ltd.
ANG Liquids Ltd.
ANGUS Chemical Company
ANGUS Chemie GmbH
ANGUS Fine Chemicals Ltd.
CanStates Energy Inc.
CanStates Holdings Inc.
Foothills Pipe Lines (South B.C.) Ltd.
Magnesium Company of Canada, Ltd.
Rankin Petroleum Inc.
Standard Pacific Gas Line Incorporated

PENNSYLVANIA OFFICE OF CONSUMER ADVOCATE

Pennsylvania Office of Consumer Advocate is the statutory representative of residential and other noncommercial users of regulated public utility service, including natural gas, in the State of Pennsylvania.

THE PEOPLES GAS LIGHT & COKE COMPANY

Parent: Peoples Energy Corporation

THE PUBLIC SERVICE COMMISSION OF THE STATE OF CALIFORNIA

THE PUBLIC SERVICE COMMISSION OF THE DISTRICT OF COLUMBIA

THE PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK

SOUTHERN CALIFORNIA GAS COMPANY

Parent: Pacific Enterprises

UNITED CITIES GAS COMPANY

(Successor to Union Gas System, Inc.)

UNITED DISTRIBUTION COMPANIES ("UDC")

UDC member companies:
Battle Creek Gas Company

Parent: Southeastern Michigan Gas Enterprises, Inc.

Central Illinois Light Company

Parent: CILCORP Inc.

Central Illinois Public Service
Citizen Gas Fuel Company
Columbia Gas System, Inc.

A registered holding company under the Public Utility Holding Company Act.

Subsidiaries:

Columbia Gas of Kentucky
Columbia Gas of Maryland
Columbia Gas of New York
Columbia Gas of Ohio
Columbia Gas of Pennsylvania
Commonwealth Gas Services, Inc.

The Dayton Power and Light Company

Parent: DPL, Inc.

The East Ohio Gas Company

Parent: Consolidated Natural Gas Company

Equitable Gas Company

A division of Equitable Resources, Inc.

Hope Gas, Inc.

Parent: Consolidated Natural Gas Company

Illinois Power Company
Indiana Gas Company

Parent: Indiana Energy, Inc.

Kokomo Gas and Fuel Company
Michigan Consolidated Gas Company

Parent: MCN Corporation

Michigan Gas Company

Parent: Southeastern Michigan Gas Enterprises, Inc.

Michigan Gas Utilities

Division of UtiliCorp United Inc.

National Fuel Gas Distribution Corporation

Parent:

National Fuel Gas Company, a public utility holding company

Niagara Mohawk Power Corporation
North Shore Gas Company

Parent: Peoples Energy Corporation

Northern Illinois Gas Company

Parent: NICOR, Inc.

Ohio Gas Company
Orange & Rockland Utilities, Inc.
The Peoples Gas Light & Coke Company

Parent: Peoples Energy Corporation

The Peoples Natural Gas Company

Parent: Consolidated Natural Gas Company

Peoples Natural Gas

Division of UtiliCorp United Inc.

Richmond Gas Corporation
The River Gas Company

Parent: Consolidated Natural Gas Company

Rochester Gas and Electric Corporation
Southeastern Michigan Gas Company

Parent: Southeastern Michigan Gas Enterprises, Inc.

Union Electric Company
Virginia Natural Gas, Inc.

Parent: Consolidated Natural Gas Company

West Ohio Gas Company

Parent: Consolidated Natural Gas Company

Wisconsin Fuel and Light Company
Wisconsin Gas Company

Parent: WICOR, Inc.

Wisconsin Natural Gas Company

Parent: Wisconsin Energy Corporation

Wisconsin Southern Gas Company

WILLIAMS NATURAL GAS COMPANY

The Williams Companies, Inc.
Apco Argentina Inc.
Northwest Pipeline Corporation

APPENDIX B

EXCERPTS FROM:

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the Fiscal Year Ended December 31, 1989

Commission File No. 1-8968

ANADARKO PETROLEUM CORPORATION

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	76-0146568 (I.R.S. Employer Identification No.)
16855 Northchase Drive, Houston, Texas (Address of executive offices)	77060 (Zip Code)

Registrant's telephone number: (713) 875-1101

* * * *

ITEM 3. Legal Proceedings

Order 451 On September 15, 1989, the Fifth Circuit Court of Appeals vacated FERC Order 451 which allowed gas producers to negotiate a price increase in certain NGPA subcategories of "old gas" up to an alternative maximum lawful ceiling price.

As a result of the application of Order 451, Anadarko was able to obtain a higher price for certain gas which

it sold during the period from August 1987 through July 1989. In addition to the reserves released under Order 451, some of the Company's gas reserves committed under long-term contracts were temporarily released under the provisions of a Limited Term Abandonment granted to the Company by FERC. Production from these reserves was sold under spot market contracts at prices above the NGPA maximum lawful price for old gas, pursuant to the pricing provisions of Order 451.

Anadarko's future natural gas sales will be largely unaffected by the Fifth Circuit Court's decision to invalidate Order 451. The Company took steps necessary to insure that a substantial portion of its regulated gas reserves qualified for early price decontrol under the Decontrol Act. As of March 31, 1989, Anadarko completed contract settlement negotiations with its major interstate pipeline purchasers, thereby providing for the termination of contracts and permanent release of virtually all of Anadarko's low-priced natural gas reserves. These settlements and contract terminations are consistent with current FERC contract-release procedures and are unaffected by the September 15, 1989 court decision regarding Order 451. Under the provisions of the Decontrol Act, future sales of this gas can be made at market prices.

APPENDIX C

UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

No. 86-1806

IN RE KN ENERGY, INC.,
Petitioner.

Submitted: July 30, 1986

Filed: August 19, 1986

PETITION FOR WRIT OF PROHIBITION OR MANDAMUS

Before JOHN R. GIBSON, FAGG, and BOWMAN, Circuit Judges.

PER CURIAM.

Invoking this Court's authority under the All Writs Act, 28 U.S.C. § 1651(a), the Administrative Procedure Act, 5 U.S.C. § 705, and the Natural Gas Act, 15 U.S.C. § 717r, KN Energy, Inc. (KN) requests a writ of prohibition or of mandamus directing the Federal Energy Regulatory Commission (Commission) to vacate its Order 451, issued on June 6, 1986. Numerous parties have intervened, some supporting KN and some supporting the Commission. KN contends that in issuing Order 451 the Commission exceeded its jurisdiction, and that irreparable injury to KN and its customers will occur before the administrative and judicial review processes are completed. We find that effective and timely review is available and we decline to issue a writ.

We note first that while we do not rest our decision on the question of venue, we doubt that venue lies in this Court of Appeals. Without extended discussion, we simply note that KN's previous filings with the Commission state that Lakewood, Colorado is its principal place of business, and it is a Kansas corporation—both states being within the Tenth Circuit. Thus either the Tenth Circuit or the District of Columbia Circuit would appear to be the appropriate circuits in which KN could seek judicial review of Order 451. 15 U.S.C. §§ 717(r)(b) & 3416(a)(4).

Relief under the All Writs Act is an extraordinary remedy that a petitioner may invoke only if the ordinary available procedures are clearly inadequate. *Reynolds Metals Co. v. Federal Regulatory Commission*, 777 F.2d 760, 762 (D.C. Cir. 1985). The petitioner has the burden of showing that it is clearly and indisputably entitled to relief. *National Farmers' Organization v. Oliver*, 530 F.2d 815, 817 (8th Cir. 1976). The grant of the writs of prohibition or mandamus is within the sound discretion of this Court. *La Buy v. Howes Leather Co.*, 352 U.S. 249, 255 (1957); *Sound Investment & Realty Co. v. Harper*, 178 F.2d 274, 277 (8th Cir. 1949). Such writs, however, "may not be invoked as a substitute for appeal and . . . will not lie as a general rule where there is a remedy by appeal even in cases where such an appeal may involve inconvenience, delay or expense to the petitioner." *Id.* at 276-77; *In re State of South Dakota*, 692 F.2d 1158, 1161 (8th Cir. 1982); *In re State of Missouri*, 664 F.2d 178, 180 (8th Cir. 1981).

To issue a writ of prohibition or mandamus, we must find that there has been an abuse of or absence of jurisdiction in the proceedings below and that the normal appeals process will not provide an adequate remedy for an erroneous or unfounded decision. *See Kerr v. United States District Court*, 426 U.S. 394, 402-03 (1976) (as a condition for issuance of a writ, party seeking it must

have "no other adequate means to attain the relief he desires . . . ."); *Ex parte Davis*, 262 U.S. 274, 276 (1923) ("[B]y appeal in the ordinary way possible errors can be corrected; and there is no imperative reason for awarding a writ of prohibition."). It must "appear that petitioner has no other plain, adequate and complete method of obtaining the relief to which he is ultimately entitled. In other words, it must appear that without the issuance of the writ there will be a miscarriage of justice." *Harper*, 178 F.2d at 277.

Because we find that KN has failed to sustain its burden of showing that the normal administrative and judicial review processes would be ineffective, we do not reach the question of whether the Commission has abused its jurisdiction or was without jurisdiction to issue Order 451. We find that the normal administrative and judicial review processes will adequately protect KN's interests, and are capable of providing KN any relief to which it may ultimately be entitled. Currently, KN and others have petitions for rehearing concerning Order 451 pending before the Commission, and the Commission's order is not yet final. Thus, the Commission itself may yet resolve the issues raised by Order 451 in a manner satisfactory to KN and to others with similar interests. KN can obtain judicial review through the ordinary appeal process once the Commission's order becomes final. Moreover, if the Commission has not issued a final order by November 1, 1986, as counsel for the Commission at oral argument before this Court represented it will, then KN may seek a stay or other judicial relief from Order 451 at that time. Accordingly, the present petition is denied.

A true copy.

Attest:

Clerk, U.S. Court of Appeals, Eighth Circuit.

APPENDIX D

MOBIL NATURAL GAS INC.

Nine Greenway Plaza—Suite 2700
Houston, Texas 77046-0957

September 28, 1987

CERTIFIED MAIL
RETURN RECEIPT REQUESTED

Williams Natural Gas Company
One Williams Center
Post Office Box 3288
Tulsa, Oklahoma 74101

Attention: Mr. J. B. Killerlain

Re: FERC Order No. 451, et seq.

Gentlemen:

Pursuant to the provisions of 18 C.F.R. Section 270.201, Mobil Oil Corporation ("Mobil") hereby requests Williams Natural Gas Company ("Williams") to nominate a price at which Williams is willing to continue buying old gas under the following contracts between Mobil and Williams:

Contract Number		Contract	
Mobil	Williams	Date	Field
S-302	678	06/17/46	Hugoton Embayment
S-5521	2103	01/05/76	Hardtner
			Aetna Gas Area
			Driftwood
			Hugoton Gas Area
			Medicine Lodge N.
			Rhodes
			Rhodes N.E.
S-5547	2206/2205	01/31/77	Mocane/Laverne
			South Glenwood
S-6033	1308	02/01/61	Hugoton Embayment
S-6041	1329	02/13/61	Hugoton Embayment
S-6042	1321	03/15/61	Hugoton Embayment
S-6066	675	02/28/46	Hugoton Embayment
S-6067	1316	03/01/61	Hugoton Embayment
S-6110	1315	02/27/61	Comanche, Sterling S.E.

Very truly yours,

MOBIL OIL CORPORATION

/s/ B. J. White
B. J. WHITE
Attorney-in-Fact

REG,III :cch

WILLIAMS NATURAL GAS COMPANY
One of the Williams Companies

October 29, 1987

RETURN RECEIPT REQUESTED

Mobil Oil Corporation
Nine Greenway Plaza
Suite 2700
Houston, Texas 77046-0957

Attn: B. J. White

Re: Purchaser's Request for Seller To Nominate Price Under FERC Order Nos. 451 and 451-A—Gas Purchase Contract(s) between Mobil Oil Corporation (MOBIL) as Seller, and Williams Natural Gas Company (WNG) as Purchaser

Dear Mr. White:

On June 6, 1986, and December 15, 1986, the Federal Energy Regulatory Commission (FERC) issued Order Nos. 451 and 451-A, respectively, in Docket No. RM86-3. Order Nos. 451 and 451-A permit the renegotiation of the price of all gas under contracts covering some old gas (NGPA Sections 104 and 106(a) gas). That renegotiation process will commence if Seller initiates the "good faith negotiation" process provided in Section 270.201 of the FERC's regulations.

By letter dated September 28, 1987, MOBIL initiated the good faith negotiation process with WNG. WNG will respond to your good faith negotiation request within the sixty (60) day period provided by Order Nos. 451 and 451-A.

In the meantime, WNG hereby requests MOBIL to nominate a price at which MOBIL is willing to continue selling all gas covered by the contracts listed on the attached Exhibit "A", and any other contracts between WNG and

MOBIL or related service agreements which covered some old gas as of July 18, 1986, even if no gas was being sold as of July 18, 1986. If MOBIL is a division of a corporation, this request also covers all contracts covering some old gas between WNG and any other division of the same corporation.

This request is without prejudice to WNG's position that Order Nos. 451 and 451-A are invalid and to WNG's right to any available remedy should Order Nos. 451 and 451-A be reversed or modified. Responses to this request should be directed to the undersigned, Post Office Box 3288, Tulsa, Oklahoma 74101.

Sincerely,

/s/ J. B. Killerlain
J. B. KILLERLAIN
Director, Gas Sales

JBK-03/kjj

EXHIBIT "A"

CONTRACTS BETWEEN MOBIL OIL COMPANY
AND
WILLIAMS NATURAL GAS COMPANY

Contract Number			
Mobil	Williams	Date	Contract Field
S-302	678	06/17/46	Hugoton Embayment
S-5521	2103	01/05/76	Hardtner
			Aetna Gas Area
			Driftwood
			Hugoton Gas Area
			Medicine Lodge N.
			Rhodes
			Rhodes N.E.
S-5547	2206/2205	01/31/77	Mocane/Laverne
			South Glenwood
S-6033	1308	02/01/61	Hugoton Embayment
S-6041	1329	02/13/61	Hugoton Embayment
S-6042	1321	03/15/61	Hugoton Embayment
S-6066	675	02/28/46	Hugoton Embayment
S-6067	1316	03/01/61	Hugoton Embayment
S-6110	1315	02/27/61	Comanche, Sterling S.E.

MOBIL NATURAL GAS INC.

Nine Greenway Plaza—Suite 2700
Houston, Texas 77046-0957

November 2, 1987

RETURN RECEIPT REQUESTED

Williams Natural Gas Company
One Williams Center
Post Office Box 3288
Tulsa, Oklahoma 74101

Attention: Mr. J. B. Killerlain

FERC ORDER NO. 451, ET SEQ.

Gentlemen:

Pursuant to your request for price nomination of October 29, 1987 Mobil Oil Corporation (Mobil) nominates the price for regulated and deregulated gas as listed below.

Regulated Gas

The price for regulated gas shall be the highest price permissible by law of the following:

(a) $4.715/MMBtu for November, 1987 escalated in accordance with NGPA Section 101(a).

(b) If the Federal Energy Regulatory Commission, or any successor governmental agency having jurisdiction in the premises, acting under any section of the Natural Gas Policy Act of 1978 or other applicable law or regulation, shall at any time hereafter prescribe, permit, or establish by any lawful means, including by policy, rule, or order an upward revision to a maximum lawful rate, national ceiling, area or other ceiling for rates and charges for the sale or transfer of natural gas that is higher than the price herein provided (including gas of any and all vintaging classifications) and which is applicable to the gas produced from Seller's properties, then the price provided under contract to be paid by Buyer to Seller for all such gas delivered or for which payment is due under the provisions of this contract shall be increased to equal such higher ceiling rate (including adjustments to such higher rate), effective the date for which such higher rate is prescribed, permitted or established. Adjustments to such higher rate shall include but not be limited to periodic rate increases; state or federal production, severance, or similar taxes and ad valorem taxes where based on production factors; upward and downward Btu adjustment; deeper drilling allowances; production related cost allowances; biennial or other review; and any other permissible adjustments. As often as the price for all or part of the gas subject to contract shall increase pursuant to this ceiling rate provision, such increased price shall be the contract price for gas under this contract and shall not be reduced in the event regulation of gas rates by the Federal Energy Regulatory Commission, or a successor, ceases or changes, and such price shall be subject to further increases in accordance with the section below on deregulated gas provisions of the contract.

Deregulated Gas

Notwithstanding any other provision of this contract, if at any time during the term of the contract, the Federal Energy Regulatory Commission (or any successor governmental authority) ceases to have authority to regulate the sale or transfer of gas under the contract, then and in any such event, a price redetermination shall be made as set forth below. The price redetermined hereunder shall in each instance be the higher of:

(a) The price in effect in this contract on the last day of the period immediately preceding the period

for which the price is being redetermined, escalated for inflation thereafter, in accordance with NGPA § 101(a).

(b) The arithmetic average of the three (3) highest prices then being paid by pipelines for gas of substantially the same quantity and quality or of lesser quantity or lower quality, and delivered under comparable conditions, and produced within the States of Oklahoma and Kansas.

(c) A price per million BTU (MMBTU) equivalent to one hundred twenty percent (120%) of the price per MMBTU for Fuel Oil No. 2 determined in the manner provided below. The price per gallon for Fuel Oil No. 2 shall be determined from the most recent monthly publication available to Seller of *Producer Price Indexes* as published by the U.S. Department of Labor, Bureau of Labor Statistics. Such price shall be derived from the table "Producer Price Indexes and percent changes for Commodity Groupings and Individual Items", under the grouping "Fuels and Related Products and Power", and subgrouping "Light Fuel Oils", under the listing "Fuel Oil No. 2 to Resellers." for use in converting the price per gallon for Fuel Oil No. 2 hereunder to cents per MMBTU, each gallon shall be deemed to contain 0.1387 MMBTU.

Said price shall be redetermined the earlier of ninety (90) days from the effective date of this amendment or within ninety (90) days after the cessation date and shall become effective for the one (1) year period commencing at the expiration of said ninety (90) day period. Thereafter, the price shall be redetermined for each succeeding annual period, using the above criteria. Such succeeding annual redetermination shall be conducted commencing ninety (90) days prior to the commencement of the annual period for which the redetermination is to be made. Buyer's obligation to pay any redetermined

price hereunder shall be limited to the portion which Seller certifies to Buyer that Seller is lawfully entitled to receive under this contract for the sale or transfer of gas.

Very truly yours,

MOBIL OIL CORPORATION

/s/ B. J. White
B. J. WHITE
Attorney-in-Fact

REGardner,III:cch

WILLIAMS NATURAL GAS COMPANY

One of the Williams Companies

November 25, 1987

CERTIFIED
RETURN RECEIPT REQUESTED

Mobil Oil Corporation
Nine Greenway Plaza
Suite 2700
Houston, Texas 77046-0957

Attn: B. J. White

Re: Purchaser's Price Nomination under FERC Orders No. 451 and 451-A—Gas Purchase Contracts Between Mobil Oil Corporation (Mobil) as Seller, and Williams Natural Gas Company (WNG) as Purchaser

Dear Mr. White:

On June 6, 1986, and December 15, 1986, the Federal Energy Regulatory Commission (FERC) issued Orders No. 451 and 451-A, respectively, in Docket No. RM86-3. Orders No. 451 and 451-A permit the renegotiation of the price of all gas under contracts covering some old gas (NGPA Sections 104 and 106(a) gas). That renegotiation process will commence if Seller initiates the "good faith negotiation" process provided in Section 270.201 of the FERC's regulations.

By your letter dated September 28, 1987, which we received September 30, Mobil initiated the good faith negotiation process with WNG. Subsequently, by letter dated October 29, 1987, WNG requested that Mobil nominate

a price at which Mobil is willing to continue selling all gas covered by the contracts in question between WNG and Mobil or related service agreements which covered some old gas as of July 18, 1986, even if no gas was being sold as of July 18, 1986. Mobil responded in a letter dated November 2, 1987, that Mobil would be willing to continue selling regulated gas at the maximum lawful price pursuant to Order 451, and it proposed to sell deregulated gas at the higher of three specified provisions.

WNG does not believe that the maximum lawful price for regulated gas, nor the potential price under the three-variable formula for deregulated gas is representative of a market price in the natural gas industry at present.

Accordingly, for all gas covered under the subject contracts WNG proposes * a price of $1.40 per MMBtu (inclusive of all adjustments), which is market responsive and provides a premium above the current spot market, recognizing the long-term nature of the supplies represented by the aforementioned contracts. WNG further proposes that the price be subject to annual redetermination and submission to arbitration in the event that the parties are unable to agree upon the appropriate fair market value for gas produced in the Kansas-Hugoton Field.

With respect to quantity, WNG proposes * to submit semi-annual purchase nominations. WNG will be obligated to take-or-pay for 75% of its semi-annual nomination. The volume in excess of WNG's nomination will be released for marketing by Mobil. Finally, in recognition of Mobil's desire to achieve relief from life of lease contracts, WNG proposes that the term provisions be amended to provide for a five year term.

We believe that a continuing arrangement structured around the principles presented in this proposal repre-

sents an approach to meet the challenges of the natural gas industry today. We will await your response.

Very truly yours,

/s/ Jack L. Finch
JACK L. FINCH
Vice President
Marketing & Supply

JLF-09/kjj

* This response is without prejudice to WNG's position that Orders No. 451 and 451-A are invalid and to WNG's right to any available remedy should Orders No. 451 and 451-A be reversed or modified.

MOBIL NATURAL GAS INC.

Nine Greenway Plaza—Suite 2700
Houston, Texas 77046-0957

November 30, 1987

RETURN RECEIPT REQUESTED

Mr. J. B. Killerlain
Director, Gas Supplies
Williams Natural Gas Company
One Williams Center
Post Office Box 3288
Tulsa, Oklahoma 74101

FERC ORDER NO. 451, et seq.

Dear Mr. Killerlain:

Mobil Oil Corporation ("Mobil") hereby rejects the price nominated by Williams Natural Gas Company ("Williams") for gas in your letter to Mobil dated November 25, 1987 which was received by Mobil on November 30 as it pertains to "old gas", NGPA Sections 104 and 106(a).

This letter shall also serve as notice that effective January 1, 1988 Mobil intends to terminate and abandon all sales of such "old gas" under the following contracts between Mobil and Williams:

Contract Number		Contract	
Mobil	Williams	Date	Field
S-302	678	06/17/46	Hugoton Embayment
S-5521	2103	01/05/76	Hardtner
			Aetna Gas Area
			Driftwood
			Hugoton Gas Area
			Medicine Lodge N.
			Rhodes
			Rhodes N.E.
S-5547	2206/2205	01/31/77	Mocane/Laverne
			South Glenwood
S-6033	1308	02/01/61	Hugoton Embayment
S-6041	1329	02/13/61	Hugoton Embayment

Contract Number		Contract	
Williams	Mobil	Date	Field
S-6042	1321	03/15/61	Hugoton Embayment
S-6066	675	02/28/46	Hugoton Embayment
S-6067	1316	03/01/61	Hugoton Embayment
S-6110	1315	02/27/61	Comanche, Sterling S.E.

Mobil interprets your letter of November 25, 1987 to be a rejection of the Mobil price nomination for all gas other than "old gas" in its letter of November 3, 1987.

Very truly yours,

MOBIL OIL CORPORATION

By /s/ B. J. White
B. J. WHITE
Attorney-in-Fact

REGardner:cch

No. 89-1452

In The
Supreme Court of the United States
October Term, 1989

Mobil Oil Exploration & Producing Southeast, Inc., *et al.*,
Petitioners,
v.
United Distribution Companies, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

---

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May 17, 1990

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REPLY BRIEF FOR PETITIONERS

Respondents' brief in opposition to certiorari is striking primarily for what it does not dispute. Respondents do not deny that this case is of immense practical importance to the entire natural gas industry, despite (indeed, because of) the enactment of the Wellhead Decontrol Act.[1] They do not deny that the court of appeals expressly held that the Federal Energy Regulatory Commission ("FERC") lacks authority under Sections 104 and 106 of the Natural Gas Policy Act ("NGPA") to set a single maximum price for all vintages of old gas. Nor do they deny that this holding, as well as the court's interpretation of Section 7(b) of the Natural Gas Act ("NGA"), fails to accord any deference to the FERC's interpretations of those provisions, contrary to this Court's decisions in *Chevron U.S.A.* v. *NRDC*, 467 U.S. 837 (1984), and *K Mart Corp.* v. *Cartier*, 486 U.S. 281 (1988). Indeed, they do not even mention the latter decision. Nor do they deny that the court of appeals' resolution of the take-or-pay question is contrary to the D.C. Circuit's decisions in *Wisconsin Gas Co.* v. *FERC*, 770 F.2d 1144 (D.C. Cir. 1985), *cert. denied*, 476 U.S. 1114 (1986), and *Neighborhood TV Co.* v. *FCC*, 742 F.2d 629 (D.C. Cir. 1984). Instead, respondents primarily argue that they should prevail on the merits, and that the unsubstantiated policy arguments on which they relied in opposing this Court's issuance of a stay also militate against a grant of certiorari.

1. Respondents' only response to the widespread, immediate impact of vacating Order 451, as explained by

[1] Indeed, virtually everyone connected with the natural gas industry—producers, pipelines, customers (some of whom support the petitioners and others the respondents), as well as the FERC, the industry's principal regulator—is now before this Court. Moreover, the Department of Energy and the Justice Department were actively involved in the proceedings before the FERC. The widespread interest in this case attests to the practical importance of the decision below.

both the private and government petitioners (Pet. 2-3, 13, 17-18, 26-29; U.S. Pet. 26-27), is to quibble over the numbers petitioners use to document the magnitude of the problem. See Opp. 17.[2] Respondents do not (and could not) dispute that the court of appeals' decision casts into doubt thousands of gas supply contracts covering billions of dollars worth of reserves (Pet. 26-27, 28-29 n.18), and that it creates a risk that approximately 1.6 *trillion* cubic feet of gas contracted to new customers under Order 451 will have to be redirected to the original customers (*id.* at 27). By themselves, these effects make this case enormously important.[3]

With respect to the future importance of the court of appeals' decision, respondents do not dispute (or even address) petitioners' demonstration that the pricing policies embodied in Order 451 were essential to Congress's decision to enact the Wellhead Decontrol Act, and that the court of appeals' decision would thwart the orderly transition to decontrol mandated by that Act. Pet. 28. Nor do they dispute that substantial quantities of gas for which wellhead price regulation will be eliminated on January 1, 1993 (when full decontrol takes effect) will, in the interim, continue to be subject to Order 451 and therefore eligible for renegotiation under the Order's Good Faith Negotiation ("GFN") procedures. See *id.* at 28-29 n.18. Nor do they dispute that Order 451 will continue to have an enormous impact beyond 1993 because many of the contracts it affects extend well beyond

[2] Petitioners' estimates of the number of contracts potentially affected by the decision of the court of appeals differs from the FERC's estimate because the former was based upon a survey of petitioners' own operations, while the latter was based upon an older DOE study. Compare Pet. 26-27 with U.S. Pet. 26.

[3] Respondents' unsupported assertion that the private negotiation procedure established by the Wellhead Decontrol Act will ameliorate these difficulties (Opp. 18) is wrong. Parties would be free to settle disputes arising from the invalidation of Order 451 without those procedures. The problem is that many unsettled disputes will be litigated in the courts or before the FERC, creating substantial costs and years of uncertainty for both consumers and producers.

that date. *Id.* Thus, respondents' unsupported claim that the Wellhead Decontrol Act deprives the decision below of "any long-term significance" (Opp. 16) is plainly wrong.

Respondents' practical arguments in favor of the decision below are belied by their own submission. In a footnote (Opp. 9 n.5), respondents concede that during the nearly four years since Order 451 took effect, and even before adjusting for inflation, the average spot market price for natural gas has *declined* approximately 20 to 45 percent. Later, respondents argue (Opp. 13) that Order 451's GFN procedure has caused increased prices for old gas and therefore should be struck down. But they ignore the other side of the equation, which was that this procedure was also designed to decrease the price of new gas by facilitating the restructuring of hundreds of inflexible, non-market responsive contracts. See Pet. 11 (citing 51 Fed. Reg. at 22,204-206). By highlighting the decline in overall prices that has occurred since Order 451 took effect, respondents footnote demonstrates that the FERC properly balanced the negotiation process, contrary to claims that the GFN process is "one-sided."[4] In any event, all of respondents' policy arguments beg the fundamental question of who should make such policy choices—the federal agency charged by Congress with regulating the natural glas industry, or two federal appeals court judges. See Pet. 5-6, 18-21.[5]

[4] Moreover, contrary to respondents' repeated suggestion (Opp. 9, 13, 17), that gas subject to Order 451 is typically sold at above-market prices, a recent Department of Energy study concludes that "almost all" of the contracts renegotiated under Order 451 limit the price to the *lower* of the market price or the regulatory ceiling price. *Natural Gas Price Controls: Hearing on H.R. 1595 Before the Subcomm. on Energy and Power of the House Committee on Energy and Commerce*, 101st Cong., 1st Sess. 156 (Apr. 5, 1989).

[5] Respondents also attempt to defend, on various equitable grounds, the distribution of the "burdens" (Opp. 19) imposed by the admitted "practical problems" (Opp. 18) created by the

2. Contrary to the misleading impression respondents attempt to create (Opp. at 21-22), the court of appeals squarely held that the FERC lacks authority under Sections 104(b)(2) and 106(c) to "abrogat[e] the vintage pricing structure" (Pet. App. 25a) by setting a single ceiling price for all vintages of old gas. After summarizing the FERC's discussion of its own authority under those provisions, the court held as follows:

> Congress' intent was, as it has been in the past, to protect the interests of the consumer through the incorporation of a vintaged old gas pricing scheme '*as a significant feature of the NGPA's design.*' . . . For the Commission to jettison a 'significant feature of the NGPA's design' by abrogating the vintage pricing structure, represents, in our view, an improper exercise by the Commission of its limited authority to raise ceiling prices under NGPA sections 104(b)(2) and 106(c). *Id.* at 24a-25a (emphasis in original).

For this reason, the court vacated the FERC's orders, concluding that the FERC "has exceeded the scope of its authority under the NGPA." *Id.* at 25a, 36a.

Respondents do not defend this holding against the errors demonstrated in the petitions for certiorari. They do not deny that it is contrary to the plain language of the NGPA. See Pet. 18-20; U.S. Pet. 22-23. Indeed, they rely heavily upon a decision of this Court that *upheld* the FERC's interpretation of another NGPA provision based solely upon its "plain language." *FERC* v. *Martin Exploration Management Co.*, 486 U.S. 204, 209 (1988). Respondents, however, studiously avoid quoting or discussing the language of the provisions at issue in this case, preferring instead to rely upon "what Congress

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court of appeals' decision. See Opp. 17-19. Such arguments might be relevant if respondents were still opposing petitioners' stay application. See, *e.g.*, *NCAA* v. *Board of Regents*, 463 U.S. 1311, 1314 (1983) (White, J., in chambers) (discussing "stay equities"). But they have no bearing whatever on whether this Court, having granted a stay, should now grant the petitions for certiorari.

had in mind." See Opp. 25. Respondents also do not deny that the court of appeals improperly relied upon legislative history to overturn a FERC interpretation that plainly does not contravene the statutory language (see Pet. 17, 20 (citing *K Mart*, *supra*); U.S. Pet. 22-23) and cannot fairly be said to be unreasonable (see Pet. 20-21 (citing *Chevron*, *supra*); U.S. Pet. 22-23).

Instead, respondents repeatedly argue that because the *particular* maximum lawful price the FERC chose exceeded the then-existing spot market price, that price necessarily fails the "just and reasonable" requirement because it amounts to "deregulation" of old gas prices. See Opp. 4, 14-15, 21-22. This, according to respondents, was "the real basis" (*id.* at 22) of the court's decision. That is wrong. The question whether FERC has authority to set a single maximum price for all old gas is distinct from the question whether that price is "just and reasonable." Although there are references in its opinion to the "just and reasonable" question, the court of appeals, as shown above (*supra* 4), clearly reached a holding on the question of the FERC's authority to set a single maximum price for all old gas. That question, which is also the principal question presented in the Government's petition, is squarely before this Court.

But even if respondents have correctly interpreted the decision below—*i.e.*, as holding that the maximum price FERC chose for all old gas is unjust and unreasonable because it is above the spot market price that existed in 1986—that is yet another powerful reason for granting certiorari. A judicial decision that a ceiling price fails the "just and reasonable" requirement whenever it is above the then-prevailing spot market price would be an extraordinary constraint, not only on the FERC's ratemaking powers, but also on the ratemaking powers of numerous agencies that regulate rates pursuant to a "just and reasonable" standard. It would be flatly contrary to this Court's repeated calls for judicial deference to a regulatory commission's application of that stand-

ard. See, *e.g.*, *Arkansas Louisiana Gas Co.* v. *Hall*, 453 U.S. 571, 577 (1981) ("No court may substitute its own judgment on reasonableness for the judgment of the Commission."); *Mobil Oil Corp.* v. *FPC*, 417 U.S. 283, 307 (1974) ("[C]ourts are without authority to set aside any rate selected by the Commission which is within a 'zone of reasonableness.'") (citations omitted).[6] And it would violate the same principles of statutory construction, embodied in such decisions as *Chevron* and *K Mart*, that the court of appeals violated in holding that the FERC lacks authority to set a single ceiling price for all vintages of old gas. See Pet. 18-21; U.S. Pet. 16-17.[7]

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[6] Such a holding also would be impossible to reconcile with this Court's *Mobile-Sierra* doctrine, which recognizes that market rates will sometimes be below the maximum rates established by the regulatory process. See *FPC* v. *Sierra Pacific Power Co.*, 350 U.S. 348, 353 (1956); *United Gas Pipe Line Co.* v. *Mobile Gas Serv. Corp.*, 350 U.S. 332, 343 (1956). Inasmuch as a price negotiated by two parties in an arms-length transaction is the definition of a market price, the NGA's "recogni[tion] that rates to particular customers may be set by individual contracts" (350 U.S. at 338) necessarily assumes that the ceiling price established under the "just and reasonable" standard of the NGA will sometimes be above the market rate. See *Pennzoil Co.* v. *FERC*, 645 F.2d 360, 372 (5th Cir.), *cert. denied*, 454 U.S. 1142 (1982). This element of the *Mobile-Sierra* doctrine, moreover, has been incorporated in Section 101(b)(9) of the NGPA. *Id.*

Nor is there any basis for respondents' assertion that rate regulation is designed solely to protect consumers by keeping rates below market levels. In order to ensure adequate supplies, rate regulation necessarily must consider investor interests as well as consumers' short-run interest in low prices. See, *e.g.*, *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944). Thus, respondents' naked assertions that consumer interests must be paramount merely raises the issue of how prices can best be structured to serve consumers' interests over the long run. Respondents' footnote 5 proves how effective Order 451 has been in that respect. *See supra* 3.

[7] Moreover, even if this Court agreed with respondents on the merits and held that the ceiling price adopted by the FERC was unjust and unreasonable, that would in no way reduce the need to resolve the fundamental issue regarding the scope of FERC's authority under Sections 104(b)(2) and 106(c). By itself, such a holding would not affect FERC's authority to set a single ceiling price for all old gas. It would therefore leave intact FERC's underlying authority to promulgate a regulation similar to Order 451, albeit with a different ceiling price.

Thus, respondents' revisionist interpretation of the court of appeals' opinion does nothing to diminish the necessity for further review by this Court.

As to the merits of respondents' argument, it is simply incorrect to label the Commission's action as "deregulation." The fact that a fluctuating spot market price may be below ceiling prices at a particular point in time does not mean that the gas is no longer subject to price controls. See Pet. 10-11, 19 n.11. Respondents themselves recognize that, at various times prior to Order 451, "the market price dropped substantially below the NGPA ceilings" (Opp. 23), yet this did not mean the gas was thereby "deregulated." The "deregulation" label also adds nothing to the analysis: As an original matter, the lawfulness of FERC's action with respect to the pricing of old gas depends upon (1) whether the Commission has authority under Sections 104(b)(2) and 106(c) of the NGPA to adopt a single ceiling price for all vintages of old gas, and (2) whether that ceiling price is just and reasonable within the meaning of the NGA. Respondents' "deregulation" argument not only fails to answer those questions, but also ignores the statutory language and this Court's decisions in *Chevron* and *K Mart*. See Pet. 10 & n.7, 14.

3. Similarly, nothing in respondents' brief casts any doubt on the need to review the court of appeals' holding on the issue of FERC's abandonment authority under Section 7(b) of the Natural Gas Act. Respondents do not and cannot deny the breadth of the court of appeals' holding, *i.e.*, that the Commission lacks authority to enact a generic, "across the board, pre-authorized abandonment provision" under Section 7(b). Pet. App. 29a. Indeed, respondents describe the court of appeals' decision as a holding that abandonment may not be granted under Sec-

tion 7(b) "without . . . any examination of the facts and circumstances of a particular proposal." Opp. 27. Thus, respondents implicitly concede that the holding raises a serious conflict in principle with *Chevron*, *K Mart* and similar decisions in the other courts of appeals, all of which counsel deference to the FERC's judgment on matters of stautory interpretation. See Pet. 22. By itself, that conflict warrants this Court's attention.

Respondents do attempt to distinguish *Associated Gas Distributors* v. *FERC*, 824 F.2d 981 (D.C. Cir. 1987), *cert. denied*, 485 U.S. 1006 (1988), and *Kansas Power & Light Co.* v. *FERC*, 851 F.2d 1479 (D.C. Cir. 1988). Contrary to respondents' assertion, however, both of those decisions plainly permitted abandonment of service under Section 7(b) *without* any "examination of the facts and circumstances" of each proposal. In *Associated Gas Distributors*, the D.C. Circuit specifically upheld as consistent with Section 7(b) a regulation in which, as in this case, "the Commission . . . identified circumstances under which pipelines are automatically entitled to abandonment of service . . ." 824 F.2d at 1015; see also *id.* at 1015-1016 & n.17. Since it was "automatic," the regulation provided no opportunity for examination of the facts of each case prior to abandonment.[8] The same was true in *Kansas Power & Light*. See 851 F.2d at 1483. Moreover, although in the latter case the D.C. Circuit did note that the complaining party would have an opportunity to challenge the abandonment collaterally—in a *later* prudence review proceeding—it plainly did not rely upon that opportunity to satisfy the "due hearing" requirement of Section 7(b). See 851 F.2d at 1484. The conflict between the decision of the Fifth Circuit in this

[8] Respondents also attempt to distinguish *Associated Gas Distributors* on the further ground that in that case the purchaser elected to reduce its purchases. Opp. 27. But this fact is irrelevant under the court of appeals' broad holding in this case that Section 7(b) does not permit "an across the board, pre-authorized abandonment provision" (Pet. App. 29a), *i.e.*, that Section 7(b) requires an "examination of the facts and circumstances of a particular proposal" (Opp. 27) before abandonment can be authorized.

case and the decisions of the D.C. Circuit in *Associated Gas Distributors* and *Kansas Power & Light* could not be more clear.[9]

Respondents' attempt (Opp. 25-26) to buttress the decision below with dicta from this Court's decision in *United Gas Pipe Line Co.* v. *McCombs*, 442 U.S. 529 (1979), does nothing to diminish the importance of the abandonment issue in this case. It is wholly unpersuasive. As petitioners have already explained (Pet. 22 n.13), the problem with the abandonment at issue in *McCombs* was that the Commission had given no approval for it, pregranted or otherwise. See 442 U.S. at 533-34. The Court's reference to "a hypothetical set of facts," moreover, was simply part of a discussion, acknowledged by the Court as dicta (see *id.* at 540), of the potential problems that would arise from *retroactive* abandonment authorization. In short, the decision below finds no support in either the holding or the reasoning of *McCombs*.

4. Finally, respondents' assertion that the court of appeals' resolution of the take-or-pay issue does "not present any question suitable for review" (Opp. 28) is without merit. The majority below plainly believed it was resolving a question "suitable for review," as evidenced by the six paragraphs of its opinion, under a separate heading, that it devoted to that issue. See Pet. App. 30a-33a. Judge Brown, moreover, criticized the majority for "presuming to *direct* the Commission to consider, and once and for all to *solve*" (Pet. App. 55a (first emphasis

[9] The FERC properly concluded (51 Fed. Reg. at 22,206) that the notice and comment rulemaking procedures it followed in promulgating Order 451 satisfy the "due hearing" requirement of Section 7(b). The Tenth Circuit has squarely held that an administrative rulemaking satisfies the "hearing" requirement imposed by Section 5 of the NGA, which is indistinguishable from that imposed by Section 7(b). *Phillips Petroleum Co.* v. *FPC*, 475 F.2d 842, 848-52 (10th Cir. 1973), *cert. denied*, 414 U.S. 1146 (1974). Thus, to the extent the decision below holds that a rulemaking does not satisfy the hearing requirement of Section 7(b), it conflicts with *Phillips Petroleum*.

added)) the take-or-pay problem, and the majority did not deny that charge. The FERC itself, moreover, plainly shares Judge Brown's interpretation of the majority's decision. See U.S. Pet. 25-26. Thus, this part of the opinion cannot simply be ignored, as respondents suggest.

Moreover, respondents do not deny that, if it is a holding, the majority's resolution of the take-or-pay issue squarely conflicts with the D.C. Circuit's decisions in *Wisconsin Gas*, *supra*, and *Neighborhood TV*, *supra*. See Pet. 23-26. Indeed, respondents do not even cite or discuss those decisions. The court of appeals' resolution of the take-or-pay issue thus presents a circuit conflict that warrants resolution by this Court, along with the other two issues presented in the petitions.

CONCLUSION

For the foregoing reasons, and for those stated in the petitions for certiorari, a writ of certiorari should be granted.

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Nos. 89-1452 and 89-1453

IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

MOBIL OIL EXPLORATION & PRODUCING SOUTHEAST, INC., *et al.*,
Petitioners,

v.

UNITED DISTRIBUTION COMPANIES, *et al.*
Respondents.

FEDERAL ENERGY REGULATORY COMMISSION,
Petitioner,

v.

UNITED DISTRIBUTION COMPANIES, *et al.*,
Respondents.

BRIEF OF *AMICUS CURIAE* STATE OF LOUISIANA IN SUPPORT OF PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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PRESS OF BYRON S. ADAMS, WASHINGTON, D.C. (202) 347-8203

QUESTION PRESENTED

Whether the Federal Energy Regulatory Commission has statutory authority to act by general rule to raise the price of "old gas" under statutory provisions which provide that the price of old gas may be increased by "rule or order" and that the increased price must be "just and reasonable within the meaning of the Natural Gas Act."

PARTIES TO THE PROCEEDINGS

A list of the parties is set forth in Appendix F to the petition of Mobil Oil Exploration & Producing Southeast, Inc. and in Appendix D to the petition of the Federal Energy Regulatory Commission.

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OCTOBER TERM, 1989

Nos. 89-1452
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v.

UNITED DISTRIBUTION COMPANIES, *et al.*,
Respondents.

BRIEF OF AMICUS CURIAE STATE OF LOUISIANA IN SUPPORT OF PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Amicus curiae, the State of Louisiana ("Louisiana") hereby submits this brief in support of the petitions for a writ of certiorari to the United States Court of Appeals for the Fifth Circuit filed in this case by

Mobil Oil Exploration & Producing Southeast, Inc. *et al.* (the "Producers") and by the Federal Energy Regulatory Commission ("FERC") (collectively the "Petitions").

OPINIONS BELOW

Louisiana adopts and incorporates by reference the statements set forth in the Petitions.

JURISDICTION

Louisiana adopts and incorporates by reference the statements set forth in the Petitions.

STATUTES AND REGULATIONS INVOLVED

Louisiana adopts and incorporates by reference the statements set forth in the Petitions.

STATEMENT

This case involves an order of the FERC, Order 451, issued in June 1986, which raised the lawful price for "old gas" covered by Sections 104(b)(1) and 106(a) of the Natural Gas Policy Act of 1978 ("NGPA"), 15 U.S.C. §§ 3314(b)(1), 3316(a).[1] On September 15, 1989, a divided panel of the Court of Appeals vacated Order 451 in its entirety. The court based its ruling on a finding that the FERC had "exceeded the scope of its authority under NGPA" when it acted by rule to raise to a single ceiling price the different ceiling

[1] Louisiana adopts and incorporates by reference the discussions set forth in the Petitions relating to the historical background to and promulgation of Order 451, and Louisiana adopts the summaries in the Petitions of the opinions below.

prices previously applicable to various "vintages" of gas.

The Court of Appeals also found unlawful other portions of Order 451 intended to give effect to the FERC's objectives, in promulgating Order 451, of ending market distortions and permitting the development of up to an estimated 11 trillion cubic feet of gas reserves which would otherwise be lost.[2]

If allowed to stand, the impact of the majority's ruling upon natural gas markets will be severly disruptive. The Producers have estimated that at least 3,000 natural gas contracts have been renegotiated or terminated on the basis of Order 451. These contracts cover some 6.85 trillion cubic feet of natural gas, worth some $13.7 billion at spot market prices as of the end of 1989.[3] The U.S. Department of Energy ("DOE") has conservatively estimated that, as of the end of 1988, 1,286 contracts had been renegotiated under Order 451, covering some 1.6 trillion cubic feet of natural gas worth some $3.2 billion at the end of 1989.[4] The majority's ruling threatens to nullify all of these contract renegotiations and terminations, and it throws into question actions and

[2] *See* FERC Petition at 6. Louisiana supports the position of FERC and the Producers on all issues. This brief, however, is limited to addressing the issue of the FERC's power to act by general rule to raise old gas prices and, in the process, to collapse the vintages previously established by the FERC's predecessor, the Federal Power Commission.

[3] Producers Petition at 13, 26-27.

[4] Natural Gas Price Controls: Hearing on H.R. 5195 Before the Subcommittee on Energy and Power of the House Committee on Energy and Commerce, 101st Cong., 1st Sess. (Apr. 5, 1989), at 156, *See* Producers Petition at 13, 26.

agreements by subsequent buyers and sellers of old gas who have acted in reliance on Order 451.

Louisiana, which is both a major gas producing state and a major gas consuming state, will be seriously harmed if the decision of the Court of Appeals is not reviewed and reversed by this Court. Louisiana produced in 1988 some 5.1 trillion cubic feet of natural gas (second only to Texas) out of a national total of 17.8 trillion cubic feet.[5] On a per capita basis, Louisiana is the nation's largest consuming state. The majority's ruling thus threatens major disruption to Louisiana's economy.

The ruling of the Court of Appeals is plainly wrong because of its failure to follow unambiguous statutory language. Both Sections 104(b)(2) and 106(c) of the NGPA explicitly authorize FERC to act by "rule or order" to raise the ceiling price of "old" gas. Under long-established rules of statutory construction, it was inappropriate for the majority of the panel below to resort to the legislative history of the NGPA in order to reach a conclusion at odds with the statutory language. In any event, the legislative history does not support the conclusion of the majority below that the FERC does not have the power to raise old gas prices by rule, as it did in Order 451.

REASONS FOR GRANTING THE PETITIONS

The heart of the Court of Appeals' majority opinion is that FERC did not have the authority to act by rule to raise the ceiling price for old gas covered by Sections 104(b)(1) and 106(a) of the NGPA to a new

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[5] I, *Natural Gas Annual 1988*, Energy Information Administration, U.S. Department of Energy, at 4.

ceiling price. The majority is plainly wrong. Sections 104(b)(2) and 106(c) expressly authorize FERC, "by rule or order" to set a "higher" maximum lawful price for old gas, so long as it is "just and reasonable within the meaning of the Natural Gas Act."[6] Order 451 does just that, and the majority failed to point to any statutory language in the NGPA that would preclude FERC from raising the ceiling prices and, in the process, eliminating previously existing distinctions between different "vintages" of gas.

To justify its interpretation of the statute, the majority relied exclusively on four floor statements by members of Congress to the effect that a purpose of the NGPA is to protect consumers. Those statements make no specific reference to the Commission's authority to raise prices under Sections 104 and 106, and they do not purport to be interpreting that authority. Given the unambiguous statutory language of Sections 104(b)(2) and 106(c), the majority erred in reaching beyond the language of the statute to base

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[6] Section 104(b)(2) of the NGPA, which in all relevant respects is identical to Section 106(c), provides:

> **Ceiling prices may be increased if just and reasonable**—The Commission may, by rule or order, prescribe a maximum lawful ceiling price, applicable to any first sale of any natural gas (or category thereof, as determined by the Commission) otherwise subject to the preceding provisions of this section, if such price is—
>
> (A) higher than the maximum lawful price which would otherwise be applicable under such provisions; and
>
> (B) just and reasonable within the meaning of the Natural Gas Act.

15 U.S.C. § 3314(b)(2); *see also* 15 U.S.C. § 3316(c).

its holding on fragments of irrelevant legislative history that are at best inconclusive. *Chevron U.S.A. Inc. v. NRDC, Inc.*, 467 U.S. 837, 842-43 (1984).[7] The majority went well beyond its appropriate role as a reviewing court and usurped functions belonging to Congress and to the FERC.

The error of the majority is spelled out clearly in the dissent of Judge Brown. Judge Brown is experienced and knowledgeable on issues relating to natural gas regulation. During his almost thirty-five years as a federal appellate judge, he has authored twenty-nine reported opinions[8] involving natural gas issues

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[7] If the majority had believed that the FERC had the power to act by rule to raise old gas prices but had exercised that power improperly or without adequate evidence (a finding the court below did not make) the appropriate response would hve been for the court to remand Order 451 to FERC for further proceedings, not to vacate it.

[8] Cobb v. Natural Gas Pipeline Co. of America, ___ F.2d ___, 1990 WL 25044 (5th Cir. 1990);

Texas Eastern Transmission Corp. v. Federal Energy Regulatory Commission, 893 F.2d 767 (5th Cir. 1990);

Brooklyn Union Gas Co. v. Federal Energy Regulatory Commission, 893 F.2d 777 (5th Cir. 1990);

Texaco, Inc. v. Federal Energy Regulatory Commission, 886 F.2d 749 (5th Cir. 1989);
Mobil Producing Texas & New Mexico, Inc. v. Federal Energy Regulatory Commission, 886 F.2d 745 (5th Cir. 1989);

Gulf South Pipeline Co. v. Federal Energy Regulatory Commission, 876 F.2d 431 (5th Cir. 1989);

Diamond Shamrock Exploration Corp. v. Hodel, 853 F.2d 1159 (5th Cir. 1988);

Amoco Production Co. v. Sea Robin Pipeline Co., 844 F.2d 1202

and has participated in the panel in one hundred six reported natural gas cases. Only two of the opinions he authored were reversed, both in the early 1960's.[9]

(5th Cir. 1988);

Louisiana Land and Exploration Co. v. Federal Energy Regulatory Commission, 788 F.2d 1132 (5th Cir. 1986);

Coastal Oil & Gas Corp. v. Federal Energy Regulatory Commission, 782 F.2d 1249 (5th Cir. 1986);

Ecee, Inc. v. Federal Energy Regulatory Commission, 611 F.2d 554 (5th Cir. 1980);

United Gas Pipe Line Co. v. Federal Energy Regulatory Commission, 597 F.2d 581 (5th Cir.), *cert. denied*, 445 U.S. 916 (1980);

Sebring Utilities Commission v. Federal Energy Regulatory Commission, 591 F.2d 1003 (5th Cir. 1979), *cert. denied*, 444 U.S. 879 (1979);

Pennzoil Co. v. Federal Energy Regulatory Commission, 591 F.2d 301 (5th Cir. 1979);

Public Service Co. of North Carolina, Inc. v. Federal Energy Regulatory Commission, 587 F.2d 716 (5th Cir. 1979), *cert. denied*; 444 U.S. 879 (1979);

In re Southwest Area Rate Case (OSWA I), 484 F.2d 469 (5th Cir. 1973);

Placid Oil Co. v. Federal Power Commission, 483 F.2d 880 (5th Cir. 1973), *aff'd*, 417 U.S. 283 (1976);

Weymouth v. Colorado Interstate Gas Co., 367 F.2d 84, (5th Cir. 1966);

J.M. Huber Corp. v. Denman, 367 F.2d 104, (5th Cir. 1966);

United Gas Pipe Line Co. v. Federal Power Commission, 350 F.2d 689 (5th Cir. 1965), *aff'd*, 385 U.S. 83 (1966);

Callery Properties, Inc. v. Federal Power Commission, 335 F.2d

Judge Brown's dissent shows compellingly how Sections 104(b)(2) and 106(c) give FERC the authority generally to raise ceiling prices for "old" gas and specifically to establish a single price applicable to the fifteen vintages established in previous administrative decisions by the Federal Power Commission.

The legal principles requiring reversal of the majority's ruling are well stated in the dissent. Of equal importance are the practical consequences of allowing the majority's decision to stand. Only if this Court issues the writs of certiorari and reverses the ma-

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1004 (5th Cir. 1964), *rev'd*, 382 U.S. 223 (1965);

Hill v. Federal Power Commission, 335 F.2d 355 (5th Cir. 1964);

Hunt Oil Co. v. Federal Power Commission, 306 F.2d 878 (5th Cir. 1962);

Hunt v. Federal Power Commission, 306 F.2d 334 (5th Cir. 1962), *rev'd.*, 376 U.S. 515 (1964);

Texas Eastern Transmission Corp. v. Federal Power Commission, 306 F.2d 345 (5th Cir. 1962), *cert. denied*, 375 U.S. 941 (1963);

Hunt Oil Co. v. Federal Power Commission, 306 F.2d 359 (5th Cir. 1962);

Freeland v. Sun Oil Company, 277 F.2d 154 (5th Cir.), *cert. denied*, 364 U.S. 826 (1960);

Truckline Gas Company v. Federal Power Commission, 247 F.2d 159 (5th Cir. 1957);

Basemore v. Whittington, 245 F.2d 943 (5th Cir. 1957);

Hunt Oil Company v. Federal Power Commission, 236 F.2d 828 (5th Cir. 1956), *cert. denied*, 352 U.S. 970 (1957).

* The information relating to Judge Brown's opinions was obtained by a computer search of decisions reported in the West Federal Reporter.

jority opinion can harmful disruptive effects to gas markets be avoided.

CONCLUSION

The petitions of the Producers and the Federal Energy Regulatory Commission for writs of certiorari should be granted.

Respectfully submitted,

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Govenor, State of Louisiana

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April 16, 1990

Attorneys for the State of Louisiana

Nos. 89-1452 and 89-1453

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

MOBIL OIL EXPLORATION & PRODUCING SOUTHEAST, INC., *et al.*,
Petitioners,
v.
UNITED DISTRIBUTION COMPANIES, *et al.*,
Respondents.

FEDERAL ENERGY REGULATORY COMMISSION,
Petitioner,
v.
UNITED DISTRIBUTION COMPANIES, *et al.*,
Respondents.

On Writs of Certiorari to the United States Court of Appeals for the Fifth Circuit

JOINT APPENDIX

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Dated: August 9, 1990

PETITIONS FOR CERTIORARI FILED MARCH 14 AND 15, 1990
CERTIORARI GRANTED JUNE 4, 1990

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IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 86-4940

MOBIL OIL EXPLORATION AND PRODUCING SOUTHEAST, INC., *et al.*,
Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

RELEVANT DOCKET ENTRIES

Date	Filings—Proceedings
1/27/87	Order of the Court on Venue (in 5th Cir.). (CC, HT, PEH).
4/2/87	Order CLARIFYING venue and DENYING motion to transfer. (CC, HT, PEH).
4/7/88	Minute Entry: Pre Hearing Conference held before J. Johnson, Aus., TX.
12/20/88	Order GRANTING motion of the Joint Opponents for expedited rescheduling of oral argument in the referenced case to the extent that this case will be rescheduled on the next occasion when Federal Energy Regulatory Commission cases are set. (CC).
8/9/89	ORDER: This case was argued to the Court on 4/17/89. Even so, the opinion of the Court has not been finalized as of this date. Therefore, both the motion for leave to intervene out of time of City Utilities of Springfield, Missouri, and the motion of Williams Natural Gas Company for stay, must be, and are, CARRIED WITH THE CASE. It is so ordered. (CC, JRB, SDJ).

Date	Filings—Proceedings
9/15/89	Decision of the court.
9/18/89	Order DENYING motion of Williams Natural Gas Company for a stay pending review. (CC, JRB, SDJ).
9/28/89	ORDER: Judge Brown's dissenting opinion in the above captioned case was issued on 9/26/89. Notwithstanding the previous majority opinion or requests for extensions of time to file petitions for rehearing, the Court has directed that the time for filing all petitions for rehearing shall run from the date of the dissent of Judge Brown, that is, 9/26/89. Therefore, all requests or petitions for rehearing will be due for filing with this Court on or before 10/10/89. (CC, JRB, SDJ).
10/16/89	Letter from Clerk's Office advising that a response to the Petitions for Rehearing and to the Petitions for Rehearing *En Banc* is appropriate.
1/9/90	Order DENYING motions of Indicated Producers and the FERC for stay of mandate pending application for writ of certiorari; further DENYING motion of Indicated Producers Intervenors to strike and for sanctions. (CC, JRB, SDJ).
1/9/90	Order DENYING alternative motion of the Indicated Producers for a 3 day stay of the issuance of the mandate in order to permit the filing of a stay application to the U.S.S.C. and for the continuation of a stay of the mandate pending the Supreme Court's action on such motion. (CC, JRB, SDJ).
1/10/90	Order of S.C. staying issuance of the Court's mandate pending receipt of responses to the application and further order of the under signed or of the Court.

FEDERAL ENERGY REGULATORY COMMISSION

RELEVANT DOCKET ENTRIES

Accession No.	Date	Proceedings
8511250082	11/18/85	Submits DOE proposed rule eliminating old gas vintaging and establishing incentive prices for certain categories of gas.
8512040673	12/2/85	Comments of the Department of Justice on Proposed Rulemaking.
8601080674	12/20/85	Notice of procedural schedule re. ceiling prices; old gas pricing structure.
8601230272	1/17/86	Petition of Associated Gas Distributors for order adopting additional procedures re ceiling prices.
8602130368	2/10/86	Fwds. petition of United Distribution Co. for summary dismissal of rulemaking proceedings.
	4/10-11/86	Public Hearing.
8606270049	6/6/86	Order #451, final rule re. ceiling prices; old gas pricing structure.
8607110160	7/3/86	Application of KN Energy, Inc. for rehearing of Order #451 and petition of KN Energy, Inc. et al. re ceiling prices; old gas price et al.
	7/2-8/86	Petitions for rehearing filed.
8607250417	7/18/86	Order staying the effectiveness of Order 451 re. ceiling prices; old gas pricing structure under RM 86-3-000.

Accession No.	Date	Proceedings
8607310629	7/28/86	Order denying petitions for stay of Order 451 re. ceiling prices; old gas pricing under RM 86-3.
8608070391	8/4/86	Order granting rehearing for further consideration re. ceiling prices; old gas pricing structure.
8612090139	12/5/86	Petition for stay of effective date re Good Faith Negotiation procedures for Ceiling Prices in RM86-3.
8612170177	12/15/86	Order 451-A granting rehearing in part/denying rehearing in part/clarifying final rule establishing new ceiling prices.
	12/16/86-1/12/87	Petitions for review filed.
8702190297	2/11/87	Order of U.S. Court of Appeals, D.C. Circuit dismissing petition for review re. United Distribution Companies. Docket 86-1665, 86-1672, 86-1673, 86-1660, 86-1664.
8702190287	2/11/87	Order of U.S. Court of Appeals, D.C. Circuit granting motions and dismissing case #'s 86-1667 and 86-1668.
8706160447	6/8/87	Cert. of record in lieu of record in 5th Circuit Court of Appeals re. Mobil Oil E&P Southeast vs. FERC. Docket 86-4940.
8711020276	10/22/87	Petition for review of FERC order No. 451-B issued 870603 and order No. 451-C issued 870805 re. Arkla Energy vs. FERC.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

51 F.R. 22168 (June 18, 1986)

18 CFR Parts 154, 157, 270, 271 and 284

[Docket No. RM86-3-000; Order No. 451]

Ceiling Prices; Old Gas Pricing Structure

Issued June 6, 1986

AGENCY: Federal Energy Regulatory Commission, DOE.

ACTION: Final rule.

SUMMARY: On November 18, 1985, the Department of Energy (DOE) issued a Notice of Proposed Rulemaking (NOPR) under section 403 of the Department of Energy Organization Act, 42 U.S.C. § 7173 (1982), for action by the Commission. 50 F.R. 48540 (Nov. 25, 1985). DOE proposed that the Commission (1) exercise its authority under sections 104(b)(2) and 106(c) of the Natural Gas Policy Act of 1978 (NGPA), to eliminate vintage-based pricing of old gas through the establishment of a uniform ceiling price equal to the highest current ceiling price for old gas, which is that for the post-1974 vintage and (2) establish incentive prices for certain categories of old gas under section 107 of the NGPA.

The Commission is amending its regulations to adopt DOE's proposed ceiling price and thereby eliminate vintaging. Producers may collect the new ceiling price only to the extent permitted by their contracts. Indefinite price escalation clauses in existing contracts provide the necessary authority; however, the producer must comply with a "good faith negotiation rule" before collecting a higher price under an existing contract. The Commission has

modified the good faith negotiation rule proposed by DOE in order to increase the rights of purchasers in renegotiating prices under old gas contracts. Accordingly, if the producer seeks renegotiation to increase the price of old gas, the purchaser may seek renegotiation to decrease the price of certain higher-priced gas purchased from the same producer.

The Commission is providing blanket sales certificates to producers and blanket transportation certificates to interstate pipelines to facilitate marketing any gas for which the producer and pipeline cannot agree on price under the good faith negotiation rule.

The Commission is deferring action on that part of the DOE proposal concerning new incentive prices under section 107 of the NGPA.

EFFECTIVE DATE: July 18, 1986.

FOR FURTHER INFORMATION CONTACT:

Christopher J. Warner, (202) 357-8440; Howard B. Schneider, (202) 357-8511; James J. Hoecker, (202) 357-8530; Richard Howe, Jr., (202) 357-8306; Darrell Blakeway, (202) 357-8213; Office of the General Counsel, Federal Energy Regulatory Commission, 825 North Capitol Street, NE., Washington, DC 20426.

SUPPLEMENTARY INFORMATION:

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I. Introduction

The Federal Energy Regulatory Commission (Commission) is adopting a final rule that revises the maximum lawful price for natural gas priced under sections 104 and 106 of the Natural Gas Policy Act of 1978 (NGPA)[1] and that establishes procedures designed to make the price for those categories of natural gas responsive to actual conditions in the competitive wellhead markets for gas. The Commission's final rule establishes a single alternative ceiling price for those categories of so-called "old gas" that were committed or dedicated to interstate commerce before the enactment of the NGPA, or subject to an intrastate rollover contract under the NGPA. The rule thereby provides for elimination of the various ceiling prices for different "vintages" of old gas previously set according to when the gas reserves were produced.

This rulemaking proceeding was initiated by the Secretary of Energy under section 403 of the Department of Energy Organization Act.[2] The Commission's objectives in adopting a final rule, like the Secretary's initial objectives, are to enable the prices for regulated natural gas to more closely reflect its value in the market, to provide more accurate price signals to consumers of natural gas, to ensure the efficient and rational development of the gas supplies that will be needed in future years, and to prevent the loss of substantial portions of the nation's supply of least-cost natural gas.

Because the current regulatory structure prices the commodity at drastically differing levels, and without regard to the actual cost of replacing dwindling reserves of gas or the costs of competing alternative fuels, the Commission is eliminating these existing market distortions, to the extent permitted under its statutory charter. It is taking action under both the NGPA and the Natural

[1] 15 U.S.C. 3314 and 3316 (1982).

[2] 42 U.S.C. 4273 (1982).

Gas Act[3] so that consumers are assured of long-term access to reasonably-priced supplies of natural gas.[4]

II. Background

A. *Procedural History*

This rulemaking proceeding began with a notice of proposed rulemaking issued by the Secretary of the Department of Energy, under section 403 of the Department of Energy Organization Act.[5] The Secretary proposed final action by the Commission by June 1, 1986.

The Secretary's proposal provided the Commission with the flexibility to establish the public hearing and comment procedures. Accordingly, the Commission established a procedural schedule for initial public comment.[6] This procedural notice identified several issues to which it directed commenters' attention. The Commission requested

[3] 15 U.S.C. 717-717w (1982).

[4] *Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Board of Mississippi*, 474 U.S. ——, 88 L. Ed. 2d 732, 745, slip op. at 14 (January 22, 1986) ("The change in regulatory perspective embodied in the NGPA rested in significant part on the belief that direct federal price control exacerbated supply and demand problems by preventing the market from making long-term adjustments.").

[5] 50 FR 48540 (November 25, 1985). Section 403 provides in pertinent part:

Sec. 403. (a) The Secretary and the Commission are authorized to propose rules, regulations, and statements of policy of general applicability with respect to any function within the jurisdiction of the Commission under section 402 of this Act.

(b) The Commission shall have exclusive jurisdiction with respect to any proposal made under subsection (a), and shall consider and take final action on any proposal made by the Secretary under such subsection in an expeditious manner in accordance with such reasonable time limits as may be set by the Secretary for the completion of action by the Commission on any such proposal.

[6] 50 FR 52935 (December 27, 1985).

comment on the scope of Commission authority to implement the Secretary's proposal, including the elements of the just and reasonable rate standard that apply to old gas prices, the operation of indefinite price escalator clauses in existing contracts for old gas, the relationship of the Secretary's proposal to the Commission's block billing proposal,[7] and the likely response of the market in developing or delivering old gas supplies. The Commision later asked for reply comments.[8] On April 10 and 11, 1986, the Commission also held a two-day public conference. There were approximately 45 participants in the public conference representing consumers, state utility commissions, producers, pipelines, local distribution companies, end-users, and other interested members of the public.

The record in this proceeding consists of approximately 113 initial and 37 reply comments, including numerous studies, and 584 pages of hearing transcript. The Commission is acting in compliance with the Secretary's schedule. This rule will become effective 30 days after publication in the Federal Register.

B. *The Secretary's Proposal*

The Secretary's proposal to revise old gas[9] prices is intended as a companion to the Commission's Order 436,

[7] As a means of addressing many of the same gas market problems highlighted by the Secretary, the Commission had previously proposed a rule that would require categories of gas purchased by interstate pipelines to be billed in ways that eliminate the distortions caused by "rolled-in" pricing of gas by pipelines. 50 FR 24180 (June 7, 1985) (Docket No. RM85-1-000; Part D; 50 FR 42372 (Oct. 18, 1985).

[8] 51 FR 7583 (March 5, 1986).

[9] "Old gas" or "old flowing gas" as used in this rule is generally natural gas that was committed or dedicated to interstate commerce on the day before enactment of the NGPA, as well as intrastate flowing gas subject to the price ceilings for intrastate rollover con-

enabling all segments of the gas industry to participate in an open and competitive gas market with non-discriminatory access to self-implementing and blanket transportation and flexible transportation rate structures.[10] As the Commission recognized in Order No. 436, gas should be priced to bring about efficiency in both its production and its consumption and to reflect the resource cost of bringing the commodity to market. In other words, prices should ensure that the consumer's willingness to pay for a unit of gas corresponds to the cost of producing a unit of gas at that time.[11] Prices should also allow the market to clear; that is, gas supplied should equal gas demanded. In addition, natural gas must be priced to avoid wasteful depletion of such a non-renewable resource. In sum, prices should respond to current conditions and decisions and not to conditions, costs, and decisions in the past.[12] The Commission and the Secretary agree that certain gas ceiling prices do not now reflect these pricing standards. The Secretary's proposal to resolve current old gas pricing problems is generally adopted by the Commission, with revisions discussed below, in furtherance of these mutual objectives. In his November 18, 1985, notice of proposed rulemaking (hereinafter, DOE proposal), the Secretary proposes that the Commission:

tracts under section 106(b). These gas supplies are priced according to NGPA sections 104 and 106, which permit the Commission to prescribe by rule or order a price higher than the otherwise applicable maximum lawful price, provided it is "just and reasonable within the meaning of the Natural Gas Act." "New gas" as used in this rule is gas priced under NGPA sections 102, 103, 105, and 108. "High-cost gas" is gas incentively priced under NGPA section 107.

[10] Order No. 436, Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, 50 FR 42408 (Oct. 18, 1985); Order No. 436-A, 50 FR 52217 (Dec. 23, 1985).

[11] *See, e.g.*, Kahn, The Economics of Regulation: Principles and Institutions, I, 65-70.

[12] *See, e.g.*, Order No. 436, 50 FR, at 42373-74, 42415-21 (October 18, 1985).

(1) Establish a single new just and reasonable ceiling price, equivalent to the current price for post-1974 old gas,[13] for all old "flowing" gas subject to NGPA sections 104 and 106(a), including elimination of the current system of pricing such old gas by the vintage of its production[14];

(2) Establish an incentive ceiling price under NGPA section 107, equivalent to 60 percent of the section 102 price in 1986 and escalated in annual increments to the full section 102 price in 1991, for certain old gas for which recovery involves "extraordinary risks or costs,"[15] namely production enhancement projects,[16] new infill wells, and existing low production or "marginal" wells[17];

[13] Under § 271.101, Table II, of the Commission's regulations, the price of post-1974 gas subject to sections 104 and 106 was $2.525 per MMBtu for deliveries during November 1985. The June 1986 price for that vintage of gas, adjusted for inflation, is $2.57 per MMBtu.

[14] Under "vintaging," first adopted by the Federal Power Commission in the *Permian Basin Rate Proceedings* ("Permian") (34 FPC 159, 185-88 (1965), aff'd 390 U.S. 747 (1968)), separate prices were set for old and new gas, with new gas prices designed to reflect current costs of new supply. As used in this final rule, "vintaging" refers to both the separate prices set by the Commission for various categories of old, flowing gas in area and national rate cases under its NGA jurisdiction prior to enactment of the NGPA, and to the NGPA's continuation of these separate prices through separate maximum ceiling prices for those categories under the NGPA.

[15] 15 U.S.C. 3317(b) and (c) (1982).

[16] The current production enhancement maximum lawful price is the lesser of the NGPA section 109 price or the renegotiated price agreed to by the parties under § 271.704(b)(3) of the Commission's regulations.

[17] The DOE proposal would create two new incentive price categories. "New infill wells" are defined by DOE in the same way as new, onshore production wells under NGPA section 103, except that outer continental shelf (OCS) wells would be included and the qualifying date would be January 1, 1986. Gas produced from such

(3) Provide for good faith renegotiation of contracts between producers and pipeline purchasers to prevent the higher price for old gas from being automatically collected under existing contracts, and provide for procedures that allow producers that are not offered a higher price for old gas supplies to conditionally abandon sales service to the existing purchaser and to sell the gas to a new purchaser for no less than a two-year term.[18]

The Secretary cites several conditions that support his proposal. He contends that vintaging distorts gas price signals in the natural gas market, raises consumer prices above market clearing levels, inhibits efficient production of least-cost supplies, and will, unless modified, result in the permanent loss of some 11 trillion cubic feet of natural gas. According to DOE, a primary problem is that overall prices for gas have not responded to competitive market conditions, despite the current surplus of available gas supplies. This failure, says DOE, is caused by the "cushion" provided by current old gas ceiling prices,

wells would be eligible for a price up to the new ceiling and would be subject to the good faith negotiation rule. DOE also proposes an incentive price category for "marginal wells", defined like stripper wells under NGPA section 108, except that 120 Mcf per day would be the production limit instead of 60 Mcf per day.

[18] Under the DOE proposal, if the purchaser nominates the ceiling price, sale of the gas would continue at the ceiling price. If the purchaser nominates a lower price, the seller may accept the nominated price or refuse it, in which case sales would continue at the existing price, but the seller would have the right at any time to sell the gas to another purchaser at a higher price if the sale was for a term of at least two years. In that event, the producer would automatically be released from any further obligation in law or contract to the existing purchaser upon 30 days notice. If a purchaser refused to nominate a price within 60 days after being requested to do so, the seller would be free to sell to another purchaser subject only to the new ceiling price and would be released from all obligation to the purchaser upon 30 days notice. In either case, abandonment would be deemed granted generically and the producer would not be required to file an abandonment application with the Commission.

which are below market-clearing levels and are "rolled in" with higher-cost gas supplies to produce a deceptively low weighted average cost of gas ("WACOG"). As a result, consumers have not realized the full benefits of wellhead market competition mandated by the NGPA. In its *Second DOE Section 123 Report*, DOE concluded:

> Price controls create an incentive for pipeline companies to purchase a mix of low-cost and high-cost gas. Consumers pay an average of these prices. Price controls on low-cost, old gas allow a high-cost domestic and imported gas to receive prices above the average price. The prices paid for high-cost gas will exceed the average price by an amount that results in the average price matching the price that consumers are willing to pay for natural gas. The price consumers are willing to pay for gas is equal to the cost of not using gas or the price of alternative fuels. Thus, the major beneficiaries of price controls on old gas are high-cost domestic producers and gas importers, *not* consumers.[19]

Vintage pricing fails to assign a reasonable share of the replacement cost or marginal cost of new supplies to purchasers of old gas, and old gas ceiling prices must therefore be corrected to take into account current competition in natural gas markets, according to the DOE proposal. In addition, existing incentive prices for high-cost gas are largely unavailable for enhanced recovery of low-cost gas supplies and, according to the Secretary, will result in the loss of over 20 trillion cubic feet of reserves. The DOE proposal is designed to eliminate market distortion, promote efficient production of gas reserves, and result in lower average gas prices as well as reduced dependence on foreign energy supplies. The Secretary

[19] U.S. Department of Energy, *Increasing Competition in the Natural Gas Market: Second report required by Section 123 of the Natural Gas Policy Act of 1978*, p. 137 (1985).

claims that it will provide net benefits to the American economy of over $25 billion over the next 10 years.

The DOE proposal would enable first sellers to claim the proposed new ceiling price only if authorized by contract. Approximately 90 percent of old gas is sold under contracts incorporating sufficient authorization in the form of indefinite price escalation clauses such as area rate clauses.[20] Most old gas producers would therefore be entitled to the new ceiling price, under the DOE proposal, only to the extent they negotiate a new or amended contract price, or find a new purchaser under the DOE "good faith negotiation" proposal. Under the DOE proposal, the existing vintage categories and applicable ceiling prices would remain in effect for sales made under contracts lacking the necessary authority.

C. *The Commission's Authority under the NGA and the NGPA*

1. Just and Reasonable Old Gas Prices

With the enactment of the NGPA, Congress comprehensively changed the method of pricing natural gas produced in the United States. Congress provided for partial phased deregulation of prices at the wellhead in recognition of the competitive nature of the wellhead market and the commodity nature of natural gas. Gas that was not contractully committed or dedicated to interstate commerce before enactment of the NGPA has been removed from the Commission's NGA jurisdiction. However, Congress retained controls over sales for resale of gas commenced before the date of enactment of the NGPA in interstate commerce. Under the NGA, gas that is dedicated to interstate commerce cannot be abandoned without the Commission's approval.

[20] Interstate Natural Gas Association of America, Initial Comments, p. 24. *See also,* Pennzoil Co. v. FERC, 645 F.2d 360 (5th Cir. 1981).

Title I of the NGPA sets prices for all interstate and intrastate "first sales" of natural gas. The ceiling prices established by sections 102 through 109 of Title I, adjusted for inflation, are the maximum lawful prices (MLPs) allowed for such gas at the wellhead. Section 121 removes ceiling prices for certain gas under sections 102, 103, 105 and 107. Sections 102 and 103 established the MLP for certain categories of new gas, section 105 established the MLP for certain intrastate gas, section 107 established the MLP for stripper well gas, and section 109 established the MLP for any category of gas which was not covered by the MLP prescribed in any other section.

This rule deals specifically with two categories still under the Commission's pricing jurisdiction. Section 104 established the MLP for gas which was committed or dedicated to interstate commerce on November 8, 1978, and for which a just and reasonable rate under the NGA was in effect on that date. In all, the Congress incorporated into the NGPA some 16 different categories of prices for section 104 gas established according to vintage. These various prices had been established by the Commission in area and national rate proceedings.[21] The NGPA incorporated these rates by reference, with monthly adjustments for inflation.

The second category of gas affected by the rule is subject to section 106 of the NGPA, which establishes an

[21] Area Rate Proceeding—Opinion Nos. 598 and 598-A, Southern Louisiana Area II, 46 FPC 86 and 633, respectively (1971); Opinion No. 586, Hugoton-Anadarko Area, 44 FPC 71 (1970); Opinion Nos. 595 and 595-A, Texas Gulf Coast Area, 45 FPC 674, 714 and 46 FPC 827, respectively (1971); Order Nos. 411, 411-A, and 411-B, Appalachian and Illinois Basin Areas, 44 FPC 1112, 1334, and 1487, respectively (1970); Opinion Nos. 468 and 468-A, Permian I, 34 FPC 159 and 1068, respectively (1965), and Opinion Nos. 662 and 662-A, Permian II; National Rate Proceedings—50 FPC 390 and 932 (1973); Opinion No. 699-H, 52 FPC 1604 (1974), Opinion No. 749, 54 FPC 3090 (1975), Opinion No. 770, 56 FPC 509 (1976), Opinion No. 770-A, 56 FPC 2698 (1976).

MLP for sales of gas subject to interstate and intrastate "rollover contracts," meaning any contracts that replace expired contracts which were in effect on the date of NGPA enactment.[22]

Sections 104, 106, and 109 [23] give the Commission the authority to prescribe, by rule or order, for any first sale of gas subject to the MLP of sections 104, 106, and 109, a price higher than the MLP otherwise applicable to such gas, *if* the price is just and reasonable within the meaning of the NGA.

Section 4 of the NGA requires that any rates for sales of natural gas be just and reasonable. This "just and reasonable" standard must guide any Commission exercise of its authority to raise the maximum lawful price of old gas. The Commission has been setting just and reasonable rates for nearly fifty years under the NGA, and there is substantial judicial guidance in establishing rates that comply with the just and reasonable mandate of NGPA sections 104 and 106.

Rates are just and reasonable if they are within a "zone of reasonableness," [24] meaning that a rate is neither so excessive as to exploit the consumer nor an unconstitutional confiscation of the property of the registered entity, in this case the gas producer. In other words, higher producer rates that do not provide offsetting benefits to the consumer are above the zone of reasonableness. Likewise, rates that do not provide the producer enough revenue to cover its operating costs and attract investment capital are below the zone.

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[22] NGPA section 2(12), 15 U.S.C. 3301 (1982).

[23] This final rule does not affect the price of gas under NGPA section 109, which governs gas committed or dedicated to interstate commerce but for which no just and reasonable rate was in effect on the date the NGPA was enacted. By statute, the MLP for this gas is equal to the highest section 104 price.

[24] FPC v. Natural Gas Pipeline Co., 315 U.S. 575 (1942).

The courts have described the breadth of Commission discretion in setting just and reasonable rates. The "end result" of a ratemaking proceeding governs whether the rate is just and reasonable,[25] as long as the rates established fall within the zone of reasonableness. The courts have indicated they will affirm rates based on any of several methodologies, ranging from a conventional utility-type ratemaking using the cost of service, to market-based pricing designed to promote certain public interests. In *City of Detroit v. FPC ("Detroit")*[26], the circuit court indicated that it would have approved a rate based on the market price of gas, if the Commission compared the results to a rate based on the conventional cost-of-service, and if the rate increase were no more than necessary to encourage exploration and development, the agency's stated purpose. Moreover, the only basis on which the Court disallowed exclusive reliance on market prices to regulate rates of small producers in its *FPC v. Texaco* (*"Texaco"*) decision,[27] was a finding that the Congress, in enacting the NGA, had subjected producers to regulation because the market was not competitive. In 1978, the Congress recognized the competitive nature of natural gas wellhead markets when it adopted Title I of the NGPA.[28]

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[25] FPC v. Hope Natural Gas Co. ("Hope"), 320 U.S. 591 (1944).

[26] 230 F.2d 810, 818-19 (D.C. Cir. 1955), *cert. denied*, 352 U.S. 289 (1956).

[27] 417 U.S. 380 (1974). The Court would have allowed the Commission to regulate small producers indirectly if the Commission had used criteria in addition to the market price to judge the reasonableness of the prices charged.

[28] See Pennzoil Co. *et al. v. FERC*, 645 F.2d 360, 378-89 (5th Cir. 1981), *cert. denied*, 454 U.S. 1142 (1982); Permian Basin Area Rate Cases, 390 U.S. 747, at 756-7 (1968) ("Producers of natural gas cannot usefully be classed as public utilities . . . . They are intensely competitive vendors of a wasting commodity they have acquired only by costly and often unrewarded search.")

In sum, courts decision affords the Commission significant latitude in setting just and reasonable rates. Under *Detroit*, the Commission should use the cost-of-service as a starting point. Other cases stress the Supreme Court's statement in *Hope* that the ratemaking method alone does not determine whether a rate is just and reasonable. A variety of methods have met the end result test. For example, the courts approved generic ratemaking in the area and national rate cases that established uniform rates for certain categories of gas. In those cases, the FPC attained certain administrative and policy objectives by setting rates for a particular category of gas that did not necessarily coincide with actual costs to the individual to produce that gas. In reviewing orders that included a minimum rate higher than the price in many existing contracts, the Fifth Circuit approved rates that exceeded producer costs.[29] Rates for old gas may be based on the cost of replacing reserves, i.e., on the marginal or replacement cost.[30] The FPC even established a new maximum rate for old gas that accounted for replacement cost by using a 1972 test year to determine cost of production from the wells, many of which were drilled up to 40 years earlier at lower absolute cost.[31]

In addition to cost-based methods that diverge from original cost ratemaking, a variety of non-cost-based fac-

[29] Tenneco Oil Co. v. FERC, ("Tenneco") 571 F.2d 834 (5th Cir. 1978), in which the Commission was held to have authority to establish a minimum rate, even though to do so abrogated existing contracts for lower prices. Among other things, the agency believed increasing prices would maximize production from existing wells and redress a bargaining imbalance among the pipelines. *See also*, Permian Basin Area Rate Cases, 390 U.S. 747, 820-21 (1968).

[30] In Shell Oil Co. v. FPC ("Shell"), 520 F.2d 1061 (5th Cir. 1975), the court approved orders establishing rates for "rollover" gas equal to rates for the newest gas. Thus, for gas sold under contracts replacing expiring contracts, the rate had no relation to the actual cost of production. *See also*, Mobil Oil Corp. v. FPC ("Mobil"), 417 U.S. 283, 320 (1974).

[31] Tenneco Oil Co. v. FERC, 571 F.2d 834, 840-42 (5th Cir. 1978).

tors may be used in determining a just and reasonable rate under the NGA. Those factors embody other public interest considerations such as increasing supply, managing demand, influencing industry structure, and achieving price stability.[32]

The FPC adopted the vintaging system in its area rate cases, phased it out under a national rate scheme that allowed old gas under "rollover" contracts to rise to the price of the newest gas, and later reinstated vintaging to mitigate the effects on consumers of dramatic increases in the cost of new gas.[33]

The history of just and reasonable rates under the NGA therefore demonstrates that the Commission has broad discretion to set rates using historical, marginal, or replacement costs and non-cost factors. When the Congress adopted the FPC's vintages in NGPA sections 104 and 106, it incorporated rates that had already departed to various degrees from the original cost of production. Significantly, the Congress expressly gave the Commission further authority to raise even those prices, provided the result would be just and reasonable under the NGA. It is this discretion that the Commission exercises here.

2. Authorization for Abandonment of Service

Another statutory mechanism enables the Commission to oversee a comprehensive regulatory scheme of interstate natural gas service. A sale for resale of natural gas in interstate commerce is subject to the Commis-

[32] *See generally*, *Detroit*, 230 F.2d at 816, *Permian*, 390 U.S. at 796, 815, Southern Louisiana Area Rate Cases ("SoLa I"), 428 F.2d 407, 426-27, 441 (5th Cir. 1970), *cert. denied*, 400 U.S. 950 (1970), *Mobil*, 417 U.S. at 320, *Tenneco*, 571 F.2d at 846, American Public Gas Ass'n v. FPC ("APGA"), 567 F.2d 1016, 1030, 1058 (D.C. Cir. 1977).

[33] *See*, *Permian*, 390 U.S. 747, *SoLa I*, 428 F.2d 407, *Mobil*, 417 U.S. 283, *Shell*, 520 F.2d 1061, *APGA*, 567 F.2d 1016.

sion's "abandonment" authority under NGA section 7. While section 7(c) requires that the Commission grant a certificate of public convenience and necessity prior to such a sale, once gas reserves have been committed to an interstate pipeline, any sales from these reserves cannot be sold to another purchaser without Commission approval under section 7(b). In other words, a producer cannot cease service to an interstate pipeline without a Commission grant of abandonment authority. Abandonment, while typically considered on a case-specific basis, has been generically authorized.[34]

During natural gas shortages in the 1970's, the Commission seldom authorized abandonment of producer sales. However, recently, for example, circumstances have allowed the Commission to further consider its policy on abandonment.[35] Recognizing that the natural gas market has moved from a regional market to a national market, the Commission broadened its abandonment policy to mitigate price distortions that restrained sales of low-priced gas. The Commission sought to provide purchasers with the opportunity to lower their gas costs by displacing high-cost gas or other fuels with purchases of more reasonably-priced gas, a policy of considerable importance to this proceeding. The Commission noted that if a party can demonstrate that abandonment would have beneficial effects on the natural gas market overall, such as increasing competition and thus contributing to a corresponding reduction in prices, and that the benefits of the abandonment outweigh any adverse effects to the purchaser to whom the gas is presently committed by contract, or that purchaser's customers, the Commission will grant abandonment.[36]

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[34] *See, e.g., FPC v. Moss*, 424 U.S. 494, 501 (1975); Order No. 319, 48 FR 34872 (August 1, 1983).

[35] *See, e.g., Felmont Oil Corp. and Essex Offshore, Inc.*, 33 FERC ¶ 61,333 (1985) (Opinion No. 245), *reh'g denied*, 34 FERC ¶ 61,296 (1986) (Opinion No. 245-A).

[36] 33 FERC at 61,657.

In this rule, the Commission grants conditional authority to abandon service if the good faith negotiation procedure fails to produce an agreement between existing sellers and purchasers of old gas under the revised MLP provisions of § 271.402. This conditional authority is provided in order to assure the overall goal of more competitive wellhead pricing and greater access to market-responsive gas under the new ceiling price structure for old gas.

D. The Need For the Final Rule

Over the last ten years, natural gas wellhead and transmission markets have undergone substantial changes in both structure and behavior. In addition, Congress has found that wellhead markets are workably competitive, and has partially deregulated wellhead prices.[37]

During this period, the Commission itself continuously has revised its natural gas regulatory policies, in order to fulfill its obligations under the NGA and NGPA to update its regulations in light of changes in natural gas markets.[38]

On the one hand, the Commission has reviewed and adjusted its regulation of natural gas in response to increased competition in gas markets brought about by the NGPA and changes in world energy prices.

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[37] Transcontinental Gas Pipe Line Corp., 474 U.S. ——— ———, 88 L.Ed. 2d 732, 745, *supra*, slip op. at 14, n. 6 ("Congress clearly intended to eliminate the distortive effects that NGA price control had had on supply and demand."); Pennzoil v. FERC, 645 F.2d 360, 378-79 (5th Cir. 1981), *cert. denied*, 454 U.S. 1142 (1982).

[38] Permian Basin Area Rate Cases, *supra* at 777 (1968) (". . . ratemaking agencies are not bound to the service of any single regulatory formula; they are permitted, unless their statutory authority otherwise plainly indicates, 'to make the pragmatic adjustments which may be called for by particular circumstances,' F.P.C. v. Natural Gas Pipeline Co., *supra*, at 586.").

On the other hand, during this period, the Commission has not revised its methodology of regulating producer sales of old gas in response to these changes in market conditions. As a result and as discussed in more detail in the Commission's response to comments, *infra*, the existing rate structure for old, flowing gas has created at least three problems for natural gas consumers, pipelines, and producers.

First, the existing rates for most old gas are below the replacement cost of gas reserves. For example, according to the Energy Information Administration, 2.1 Tcf of "old gas," out of a total of 8.4 Tcf of all gas purchased from non-affiliated producers by major interstate pipelines, were priced at or below $2.12 per MMBtu in 1984, as compared to overall average wellhead prices of $2.78 per Mcf, and average new gas prices of $3.65 per Mcf in the same year. Therefore, consumers of gas are neither seeing nor paying the true costs of replacing each unit of old gas with a new unit of reserves. Most producers of old gas are not receiving revenues equivalent to the marginal costs of replacing depleted old gas reserves, and gas reserves are being consumed faster than they are being replaced. Between 1978 and 1984, reserve additions averaged only 90% of consumption. As the comments in this record indicate, in many cases producers are shutting in existing reserves of old gas because they are uneconomic to produce under the artificially low ceiling prices. On the other hand, producers are obtaining higher prices for new and high-cost gas reserves which are frequently more expensive to recover than existing old gas reserves. As of March 1986, the average cost of new and high-cost gas was $3.38 per Mcf, while the Energy Information Administration estimates over 11 Tcf of additional old gas could be recovered at $2.57 per MMBtu. Thus, valuable supplies of inexpensive old gas are being inadequately developed or prematurely abandoned, while investment capital is being inefficiently allocated to more expensive supplies of new gas.

Second, the existing rates for old, flowing gas vary widely by vintage, based on the date of its dedication to interstate commerce. The overall prices consumers pay for gas depend directly on the access of their pipeline suppliers to these cheaper vintages of gas. Therefore, wide variations in pipeline access to old gas have created huge disparities in the prices consumers pay for gas at the burner-tip around the country. For example, in 1984, the average residential price of gas in Washington, DC was $8.05 per Mcf, while the average price in Kansas was $4.49 per Mcf. Kansas is served by KN Energy and Northern Natural, whose old gas "cushions" in 1984 amounted to 65 percent and 47 percent of their wellhead purchases, respectively. On the other hand, Washington, DC is served by Transcontinental Gas Pipe Line, whose 1984 old gas cushion was only 28 percent of its total purchases. Unequal access to low-cost old gas gives certain consumers and regions of the country artificial and unfair competitive advantages over other consumers and regions not served by pipelines with large "cushions" of such gas. This means consumers, purely by the historical accident of vintaging, pay different gas prices for reasons wholly unrelated to the value of the commodity or the cost of replacing it.

Third, the pricing of old, flowing gas below replacement cost gives pipelines with large "cushions" of such gas the ability to "roll-in" their prices of new and deregulated gas with artificially low old gas prices. This allows the pipelines to effectively subsidize the prices of new and deregulated gas above what consumers would otherwise be willing to pay, and therefore frustrates the efficient working of competitive wellhead markets. This cross-subsidy is unfair to consumers, because they pay above-market prices for incremental supplies of gas. It also creates distortions in the price signals which are transmitted from the wellhead to the burner-tip and back again, and thus misallocates capital and expenditures by consumers and producers alike.

In considering whether old, flowing gas rates need to be revised in order to resolve these problems, the Commission has reviewed the history of its efforts to regulate producer rates, both before and after enactment of the NGPA.

1. Producer Ratemaking Under Phillips

In 1954, the year the Supreme Court held that independent producer rates were subject to regulation under the Natural Gas Act,[39] the level of proved domestic reserves of natural gas stood at 211 trillion cubic feet (Tcf), and gas markets consumed 8 Tcf of those reserves. Wellhead prices averaged 10 cents per thousand cubic feet (Mcf), and domestic producers added more than 20 Tcf to the domestic reserve base, more than double the annual consumption rate.[40]

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[39] Phillips Petroleum Co. v. Wisconsin, ("Phillips") 347 U.S. 672 (1954).

[40] Unless noted otherwise, all statistical data and calculations in this section are derived from the following sources: U.S. Energy Information Administration ("EIA"), *NaturalGasMonthly*, Table 1 (Summary of Natural Gas Production in the United States, Consumption in the United States, 1980-January 1986), Table 5 (Projected Volumes and Prices of Wellhead Purchases by NGPA Category, 1981-March 1986), Table 6 (Estimated Surplus Natural Gas, 1981-January 1986) (February 1986) (DOE/EIA-0130(86/02)); EIA, *Natural Gas Annual 1984*, Volume I, Table 13 (Consumption of Natural Gas), Table 17 (Average City Gate Price of Natural Gas, 1984, by State), Table 19 (Average Price of Natural Gas Delivered to Consumers, 1983 and 1984, by State), Table 24 (Quantity and Average Price of Natural Gas Production, 1930-1984), Table 26 (Natural Gas Consumption in the United States, 1930-1984), (1985) (DOE/EIA-0131(84)/1); EIA, *Annual Energy Review 1984*, Table 11 (Fossil Fuel Prices, 1949-1984), Table 31 (Oil and Gas Exploration and Rotary Rigs in Use, 1949-1984), Table 32 (Exploratory Wells Completed, by Well Type, 1949-1984), Table 33 (Total Wells Completed, by Well Type, 1949-1984), Table 36 (Proved Reserves of Liquid and Gaseous Hydrocarbons, Yearend 1949-1983), Table 59 (Natural Gas Production, 1949-1984), Table 60 (Natural Gas Supply and Disposition, 1949-1984), Table 61

In 1960, six years later and the year the Federal Power Commission (FPC) formally abandoned its efforts to regulate producer rates on a case-by-case basis, the average wellhead price was only 14 cents per Mcf, despite a 50 percent increase in demand to 12 Tcf and a 30 percent decline in the average rig count over the intervening years. Proved reserves stood at 262 Tcf, but the ratio of reserves to production (R/P ratio) had declined 25 percent, from 27 to 1 in 1950 to 20 to 1 in 1960.

2. Area Rates and Vintaging

In response to the infeasibility of case-by-case ratemaking the FPC between 1960 and 1965 initiated areawide producer ratemaking with the *Permian Basin Area Rate Cases.*[41] However, the FPC based its area rates on the premise that gas contracted for *prior to* January 1, 1961, was merely a by-product of exploration for oil, and therefore "replacement cost" rates were inappropriate for such "flowing" gas. However, it relied primarily on replacement cost for setting rates for new gas. Because two different cost rationales were used to set prices for the same commodity, the experiment of "vintaging" was thus begun.[42]

Despite the FPC's area rates and first vintaging experiment, the decline in reserves and exploratory drilling

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(Consumption of Natural Gas by End-Use Sector, 1949-1984), Table 63 (Natural Gas Wellhead and Import Prices, 1949-1984) (April 1985) (DOE/EIA-0384(84)); EIA, *U.S. Crude Oil, Natural Gas, and Natural Gas Liquids Reserves, 1984 Annual Report* (September 1985), discussed in Wingenroth and Davis, "U.S. Natural Gas Reserves Statistics," *Gas Energy Review* (Vol. 13, No. 11, American Gas Association, November 1985).

[41] Statement of General Policy No. 61-1, 24 FPC 818 (1960); Opinion 468, 34 FPC 159, Opinion 468-A, 34 FPC 1068 (1965), *aff'd* Skelly Oil Co. v. FPC, 375 F.2d 6 (10th Cir. 1967), *aff'd* Permian Basin Area Rate Cases, *supra*, 390 U.S. 747 (1968).

[42] Opinion 468, 34 FPC at 186-87 (1965).

continued. Between 1960 and 1972, wellhead prices rose five cents, from 14 cents per mcf to 19 cents per mcf. At the same time, gas demand increased substantially from 12 Tcf to 22 Tcf and proved reserves declined from a peak of 293 Tcf in 1967 to 266 Tcf in 1972 and 228 Tcf in 1975, a 22 percent drop in eight years. The average rig count hit a 20-year low of 976 in 1971 and curtailments of gas supplies to the interstate market began.[43]

[43] H.R. Rep. No. 95-496, Part 4, 95th Cong., 1st Sess. (1977), "Committee on Interstate and Foreign Comerce, H.R. 6831), "National Energy Act", at pp. 90-92. "Beginning in 1967 and continuing in each succeeding year up to the present, U.S. natural gas consumption has exceeded additions to proven reserves in the contiguous 48 states . . . Moreover, due to increasing demand for natural gas and relatively stable rates of production, annual demand for natural gas has exceeded natural gas production since 1973. As a result, many interstate natural gas pipeline companies have been increasingly unable to meet their contractual delivery requirements to customers in many regions of the country. Many natural gas distribution companies have in turn found it necessary to deny gas service to new customers and to curtail service to some existing customers. Firm curtailments reported by interstate pipelines have grown from 1.0 Tcf during the April 1970 through March 1971 delivery year to 3.4 Tcf during the 1976-77 delivery year. The Federal Power Commission projects that firm curtailments will reach 3.8 Tcf during the 1977-78 delivery year. This would amount to 26.6 percent of firm requirements.

"In response to the rapid expansion in natural gas demand, unregulated intrastate natural gas prices rose above regulated interstate prices. During the period from 1969 to 1976, interstate natural gas prices for new contracts rose by "more than 700 percent, from approximately 19.8 cents per Mcf to over $1.42 per Mcf. However, during the same period, intrastate natural gas prices rose at an even greater rate, from approximately 18 cents per Mcf in 1969 to as high as $2.39 per Mcf in 1977, better than a 1,300-percent increase.

"As a result of the recently developed disparity in natural gas prices between the intrastate and interstate markets, new discoveries of natural gas reserves have been sold with increasing frequency in the intrastate, rather than the interstate, market. In large measure, present stable supply conditions in intrastate markets have resulted from the inability of the interstate market to compete for new supplies of natural gas.")

3. National Rates

When it became clear to the FPC that area rates were too low to call forth adequate supplies for interstate consumers, the Commission initiated national rate proceedings in 1973 in order to stimulate increased production.[44] In these proceedings, Commission found that its different vintages of area rates were distorting gas prices not only below the current replacement cost of gas, but also below the actual market prices for alternative fuels, such as oil. As a result, the FPC determined to phase-out the "vintaging" of rates for old and new gas.[45] In a companion proceeding, the Commission also determined to collapse all pre-1973 vintages of old, flowing gas into one minimum national rate.[46] The Commission found that "there is no rational basis for setting differing price levels based upon date of discovery," and therefore determined to establish "a uniform base price for gas sold in interstate commerce, which equates to the cost of replacing the unit of gas consumed." [47]

But in 1976, the FPC partially reserved itself, and in Opinions No. 770 and 770-A reinstated a limited form of vintaging for both pre-1973 vintages and 1973-1974 "biennium" gas.[48] The Commission justified its decision by noting that it was nearly tripling the base rate for *new* post-1974 gas supplies from $0.52 per Mfc to $1.42 per Mcf, and therefore had "carefully scrutinized the disparity between new prices and old prices to avoid an

[44] *See* Opinion No. 699-H, *supra*; Opinion No. 749, *supra*.

[45] Opinion No. 699-H, *supra*, 52 FPC 1604, 1636-38 (1974).

[46] Opinion No. 749, *supra*.

[47] Opinion No. 699-H, *supra*, 52 FPC at p. 1636-38.

[48] Opinion No. 770, *supra*, 56 FPC 509, 521 (1976).

unreasonable increase in rates." [49] However, the FPC restated its previous finding that "it is only fair that consumers of 'flowing gas' share the burden of financing the added exploration" and its intention to apply rates for flowing gas "functionally in order to assist in the generation of sufficient capital for expanded exporation and development programs." [50]

4. The Failure of National Rates and Adoption of the NGPA

Despite the adoption of new national rates for new and flowing gas, average wellhead prices continued to be below the Btu-equivalent prices of alternative fuels following the 1973-4 OPEC oil embargo. Curtailment of gas supplies to interstate markets widened between 1973 and 1977, culminating in the emergency gas shortages of the winter of 1976-1977.[51] Proved reserves continued their decline, reaching a thirty-year low of 195 Tcf in 1979, despite stable levels of demand averaging about 20 Tcf between 1972 and 1979. And in spite of the increase in average wellhead prices from 30 cents per Mcf in 1974 to 91 cents per Mcf in 1978, reserve additions in the lower-48 states averaged only 46 percent of annual production during the decade preceding enactment of the NGPA.[52]

[49] *Id.*, at 523.

[50] Opinion No. 770-A, *supra*, 56 FPC 2698, 2714-15 (1976).

[51] H.R. Rep. No. 95-496, Part 4, "National Energy Act," *supra*; *see also* Emergency Natural Gas Act of 1977, P.L. 95-2, 91 Stat. 4, enacted by Congress in early 1977 in eight days, as an urgent response to a severe natural gas shortage endangering the supply of natural gas for high-priority uses. The Act gives the President extraordinary authority to declare a natural gas emergency and mandate transportation and sale of natural gas to meet the requirements of high-priority users.

[52] Wingenroth and Davis, "U.S. Natural Gas Reserves Statistics," Gas Energy Review (Vol. 13, No. 11, AGA, November 1985) ("Overall, reserve additions in the lower-48 states [in 1984] were 82.4% of production, thus for the period of 1981-1984 reserve

The NGPA interrupted the Commission's third national rate proceeding in five years.[53] It did this by comprehensively removing new gas from the NGA jurisdiction of the Commission, by establishing new ceiling price categories for new and high-cost gas, and by setting incentive prices for certain marginal old gas supplies ("stripper wells"). The NGPA also partially removed the Commission's NGA jurisdiction over old, flowing gas, by incorporating the then-existing national rate structure for such gas into the statute, and applying to it an annual inflation factor. However, the NGPA authorized the Commission in its discretion to revise old, flowing gas rates as long as it revised the rates up, not down, and as long as it determined that such revised rates were "just and reasonable within the meaning of the Natural Gas Act." [54]

Finally, to protect against interstate pipelines "bidding up" new gas prices above market-clearing levels due to the "rolled-in" pricing of disparate prices for old and new gas, the NGPA established a scheme of incremental pricing to allocate a disproportionate share of higher gas prices to those major fuel-switchable users expected to be most able to "bargain down" any such "bidding up." [55]

The alternative fuel ceiling on which incremental prices were based under the NGPA had little effect on the bidding-up of new gas prices. The Commission in

additions in the lower-48 states have averaged 96%. This compares with a 46% replacement level during the decade preceding enactment of the Natural Gas Policy Act of 1978.")

[53] National Rates for Jurisdictional Sales of Natural Gas From Wells Commenced On or After January 1977, For the Period January 1, 1977, to December 31, 1978, Docket No. RM77-13, 57 FPC 1238 (1977).

[54] 15 U.S.C. §§ 3314(b)(2), 3316(c).

[55] Statement of Rep. Dingell, 95 Cong. Rec. H13114 (daily ed. October 14, 1978).

1980 declined to expand incremental pricing to smaller fuel-switchable users, and its decision was supported in Congress.[56]

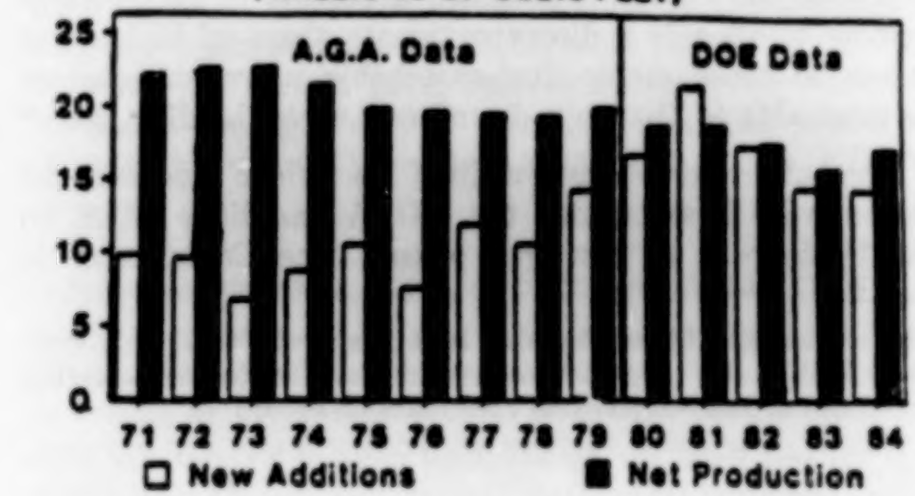
5. Market Disorders Under the NGPA

The market initially responded to the NGPA with a boom in drilling. The average rig count jumped from 2001 in 1977 to 2909 in 1980 and 3970 in 1981. Exploratory gas well completions, which had hit a low of 470 in 1971, jumped from 1560 in 1977 to 2550 in 1981.

However, this drilling boom could be misleading. Although average wellhead prices increased from 91 cents per Mcf in 1978 to \$1.98 per Mcf in 1981, additions to reserves continued to fall short of replacing production, even though lower-48 additions did increase to 90% of production for the period 1978-84, as Figure 1 indicates.

Figure 1

NET PRODUCTION AND NEW ADDITIONS TO GAS RESERVES (TRILLIONS OF CUBIC FEET)



[56] For an explanation of the effect of incremental pricing on new gas prices, *see* H.R. Rep. No. 96-938, 96th Cong., 2d Sess. (1980), H Res. 655, "Incremental Pricing of Natural Gas," Committee on Interstate and Foreign Commerce.

Although the NGPA stimulated drilling and new gas production, it also expanded the categories of old and new gas subject to different price ceilings and for the first time extended price ceilings to the previously unregulated intrastate market.[57]

For example, the average wellhead price of "old" gas in November 1978 was approximately 90 cents per Mcf, rising to \$1.62 per Mcf by January 1983, before stabilizing between \$1.40 to \$1.45 per Mcf since 1983. The average price of "new" gas rose from \$2.03 per Mcf in December 1978 to \$3.75 in December 1984, a nearly 85 percent increase in six years. But the average price of "high-cost" gas under section 107 of the NGPA went for a roller-coaster ride, up from approximately \$5.70 per Mcf in early 1981 to a peak of \$7.31 per Mcf in 1982, before plummeting to \$3.89 per Mcf by February 1986—a 28 percent increase followed by a 47 percent fall in only five years.

However, disparities in wellhead prices were not the only fact of life under the NGPA. Beginning in 1982, alternative fuel prices stabilized and then fell, accompanied by an economic slowdown and warmer than normal weather. What happened next was a 17 percent decline in gas consumption between 1979 and 1983, coinciding with the NGPA drilling boom and the rush by interstate pipelines to bid up prices of new and high-cost gas committed to the interstate market.

By 1982, pipelines were stuck with large volumes of unmarketable new and high-cost gas whose above-market prices contrasted with their below-market priced old gas. As oil prices fell below equivalent burner-tip prices of gas, large fuel-switchable users shifted to oil, and the pipelines were forced to raise their city-gate prices in

[57] 18 CFR 271.501-504, 601-603 (1985); 15 U.S.C. 3315, 3316(b) (1982).

order to recover the costs of their unmarketable gas and fixed transmission costs from a decreasing customer base.[58]

These market disorders, attributable by many to the distortions in wellhead purchasing practices caused by vintage pricing and the NGPA itself,[59] created the para-

[58] H.R. Rep. No. 98-814, 98th Cong., 2nd Sess. (1984), Committee on Energy and Commerce, H.R. 4277, "Natural Gas Market Policy of 1984" at pp. 22-24. (" . . . The drop in the world oil price late in 1982 caused residual fuel oil prices to fall below natural gas prices, so that those industrial plants capable of doing so switched from gas to oil. In response to steadily increasing prices, significant conservation was achieved by industrial, commercial, and residential users. In the winter of 1983, abnormally warm weather reduced space heating demand for gas by residential and commercial users . . . [T]he loss of large blocks of gas sales on any given system leaves the remaining customers paying a larger share of the fixed costs of the transmission and distribution systems.").

[59] S. Rep. No. 98-205, 98th Cong., 1st Sess. (1983), Committee on Energy and Natural Resources, S. 1715, "Natural Gas Policy Act Amendments of 1983" p. 10 ("In part the NGPA is not operating as originally designated . . . [W]hat was not fully appreciated was that despite Federal cost-passthrough regulations, pipelines could in effect use this 'cushion' [of 'old' price-controlled gas] to subsidize the acquisition of new and deregulated gas supplies. This occurs as a result of 'rolled in' gas pricing whereby a pipeline's customers are charged the average price of the gas they are consuming, rather than the marginal cost of new gas supplies."); Comments of Natural Gas Supply Association (NGSA), Docket RM85-1-000 (Parts A-D), at p. 1 (NGSA "believes that current disorders in the natural gas market can only be eliminated if the industry is placed on a true competitive footing. This can be accomplished if . . . (ii) existing market distortions resulting from prior regulatory policies are eliminated."); *Maryland People's Counsel v. FERC*, 761 F.2d 770-71 (1985) ("The problem ultimately giving rise to the present litigation is that the 1978 predictions of the 1985 market were much in error. Factors ranging from the increased wellhead prices and impending total decontrol, to greater energy conservation, to the lower prices of competing fuels, have turned the natural gas shortages of the 1970's into a natural gas surplus. Thus, as early as the summer of 1983—a year and a half before the scheduled deregulation of new gas—the formulary

dox of 1982-1984: The city-gate price to consumers of gas went up in the midst of a surplus of deliverability and declining demand.

In response to these market disorders at both ends of the pipe, the Commission between 1982 and 1985 made a number of changes in its regulations. For example, in response to fuel-switching by industrial users, the Commission authorized, on an experimental basis, special marketing programs for the transportation of "self-help" gas to fuel-switchable users by producers willing to provide take-or-pay relief to their pipeline purchasers. Likewise, in order to ensure that post-1982 wellhead contracts were more market-responsive, the Commission adopted a presumption that take-or-pay requirements in excess of 75% were imprudent in new wellhead contracts. In order to ensure that all gas consumers would share in the benefits of increased gas-on-gas competition caused by lower demand and falling oil prices, the Commission promulgated

statutory maximum price for new gas had already reached or exceeded the market-clearing price in many geographic markets");

Testimony of C. M. Butler III, Chairman, Federal Energy Regulatory Commission, before Committee on Energy and Natural Resources, United States Senate, November 5, 1981, p. 2 (. . . the most serious deficiency of the NGPA has not been its complexity or the dependence on the active participation of state agencies, but rather the statute's establishment of a new *dual market*, that is, one in which some gas prices are regulated while others are not . . . . The market-ordering problems created by NGPA's regime of partial regulation are already evident in the prices being paid for deregulated gas and in the supply problems of some interstate and intrastate pipelines.");

Testimony of George H. Lawrence, President, American Gas Association, before the Subcommittee on Energy Regulation and Conservation, United States Senate, July 11, 1985, p. 5 (citing "the dramatic improvement in natural gas supplies since the NGPA was enacted. These supply improvements in response to the higher NGPA prices have demonstrated conclusively that interstate market gas supply problems during the 1970's reflected the inadequacies of wellhead price controls rather than the limits of the domestic gas resource base.")

a rulemaking prohibiting pipelines from including variable costs for gas not taken in the minimum bills they charge their sales customers at the city-gate.[60] However, the Commission considered but failed to adopt any changes to its vintage rates for old, flowing gas.[61]

Despite increased competition and changed regulations at the city-gate, demand failed to revive with the general economic recovery in 1984. Immediately prior to partial wellhead deregulation in 1985, wellhead prices widely diverged among different categories and on different pipeline systems, with some categories of new and high-cost gas still averaging $3.93 per Mcf while old gas remained at $1.54 per Mcf. Finally, by the end of 1984, the marketplace was still failing to clear some 3 Tcf of surplus deliverability that had built up since 1981.

6. Natural Gas Markets Since January 1, 1985

The Commission adopted rules to implement the partial deregulation of new gas on January 1, 1985, as required by the NGPA, even over the objections of some producers that deregulation would subject them to lower prices instead of their higher contract prices pegged to regulated price ceilings.[62]

[60] *See Tenneco Oil Co., et al.*, 28 FERC ¶ 61,383, *order on reh'g*, 29 FERC ¶ 61,334 (1984); *Maryland People's Counsel v. FERC*, 761 F.2d 768 (D.C. Cir. 1985); *Maryland People's Counsel v. FERC*, 761 F.2d 780 (D.C. Cir. 1985); Statement of Policy on Take-or-Pay Provisions in Gas Purchase Contracts, Docket No. PL83-1-000, 3 FERC Stat. and Reg. ¶ 30,410 (1982), 47 FR 57268 (1982), (*codified* at 18 C.F.R. part 2) Elimination of Variable Costs from Certain Natural Gas Pipeline Minimum Commodity Bill Provisions, 49 FR 22778 (June 1, 1984) (Order No. 380); *order on reh'g*, 49 FR 31259 (August 6, 1984), *aff'd*, *Wisconsin Gas Co. v. FERC*, 770 F.2d 1144 (D.C. Cir. 1985).

[61] Impact of the NGPA on Current and Projected Natural Gas Markets, 47 FR 19157 (May 4, 1982) (Docket No. RM82-86). The Commission formally incorporates the public record in Docket No. RM82-86 into the record of this proceeding.

[62] Deregulation and Other Pricing Changes on January 1, 1985, Under the Natural Gas Policy Act, 49 FR 46874 (Nov. 29, 1984)

In anticipation of further competition at the city-gate following partial wellhead deregulation, the Commission engaged in a year-long inquiry into its policies governing the transportation of gas for others, and the impact of its policies on the industry's ability to respond to the new competition. Following this inquiry, the Commission adopted comprehensive regulatory changes designed to encourage pipelines to offer non-discriminatory access to transportation services, in return for providing pipelines with regulatory flexibility to provide such services.[63]

In the same docket, the Commission continued to review wellhead market disorders, this time focusing on the ability of pipelines to purchase deregulated or high-cost natural gas at above-market prices, and then to "roll-in," or otherwise subsidize, those high prices at the city-gate with below market prices for regulated "old" gas.[64]

Despite these further regulatory changes, the first year of partial wellhead deregulation failed to eliminate wellhead price disparities. Prices in the burgeoning spot gas market declined from approximately $3 per Mcf to close to $2 per Mcf through the year. Similarly, the average wellhead price of new gas fell from $3.78 per Mcf to $3.33 per Mcf over the 12-month period, despite the predictions by some that wellhead prices would "fly-up" on January 1, 1985.[65] But in spite of an overall 15 percent

(Order No. 406); *order on reh'g*, 49 FR 50637 (Dec. 31, 1984) (Order No. 406-A).

[63] Order No. 436, Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, 50 Fed. Reg. 42,408 (October 18, 1985), *order on reh'g*, Order No. 436-A, 50 FR 52217 (Dec. 23, 1985).

[64] Order No. 436, *supra*, Notice Requesting Supplemental Comments (Docket No. RM85-1-000 (Part D)).

[65] "Analysis of Price Fly-Up Under the Natural Gas Policy Act," April 1984, Interstate Natural Gas Association of America ("In the absence of significant renegotiation or a legislative solution, nonmarket sensitive price and take provisions in existing contracts

decline in the weighted average cost of gas to interstate pipelines between February 1985 and February 1986, average monthly gas utility prices at the city-gate declined only 5 percent over the same period.[66] This lag in city-gate prices persists at a time when demand continues to be soft and wellhead markets continue to face over 3 Tcf in surplus deliverability.

Today, ten years after the Commission partially reinstated vintaging and one-and-a-half years after partial decontrol, the inequality of incentives for production has widened, not narrowed. Four trillion cubic feet of gas, 43% of wellhead purchases by interstate pipelines, remains subject to base rates which have not been updated since 1976. Of the 4 Tcf of old, flowing gas, 2.1 Tcf, or 25 percent of all interstate purchases, is subject to

will push the average wellhead price up to 9% to 12% above inflation in 1985."); "C/LEC's Rothschild Out to Capture Competitive Benefits for Consumers," *Inside FERC's Gas Market Report*, April 18, 1986, at p. 3 ("The Citizen/Labor Energy Coalition, once a staunch opponent of gas price deregulation, now believes that in markets that are competitive, regulation is not necessary, says Edwin Rothschild, assistant director and chief Washington lobbyist . . . 'We were wrong,' Rothschild willingly admits about the predictions of a catastrophic runup in gas prices that C/LEC made about the effect of partial gas-price decontrol on Jan. 1, 1985. While conceding that gas prices have gone the opposite way from C/LEC's projections. Rothschild added that 'we were in wonderful company, AGA, most of the financial analysts and the pipelines were also wrong about the price direction as well.'"); Testimony of George H. Lawrence, President, American Gas Association, before Subcommittee on Energy Regulation and Conservation, Committee on Energy and Natural Resources, United States Senate, April 15, 1986 ("The ultimate goal should be to make all gas, old and new, market-responsive. In today's volatile energy marketplace, which is dominated by rapidly declining crude oil and product prices, we need to do everything possible to stimulate gas demand by making prices more market-responsive and removing outdated constraints on its use . . . The best solution to the take-or-pay problem has always been to sell more gas.")

[66] Monthly Gas Utility Statistical Report, American Gas Association, January 1986.

rates substantially below even current spot prices of $2 per Mcf.[67] As of March 1986, the average wellhead price of all vintages of old, flowing gas is $1.39 per Mcf, $1.08 (44 percent) below the $2.47 per Mcf average price for all wellhead purchases by major interstate pipelines.

Massive disparities in consumer gas prices persist across different pipeline systems and region of the country. In 1984, average delivered gas prices to consumers in the continental U.S. varied from a high of $9.58 and $8.80 per Mcf in Maine and Connecticut, to a low of $4.37 and $4.49 per Mcf in Arkansas and Kansas. Pipeline purchased gas costs in 1984 varied, because of unequal access to old gas, from a low of $1.71 and $2.12 per Mcf on KN Energy and Northwest Central pipelines, respectively, to a high of $3.95 and $3.60 per Mcf on Columbia Gas Transmission and Trunkline, respectively.[68] This unequal access to old gas persists even though eight years have elapsed since Congress enacted the NGPA, a statute expressly intended to create a uniform national market for gas at the wellhead.[69]

The current surplus deliverability of gas cannot blind this Commission to the data on long-term supply reliability. In 1984, according to EIA, proved gas reserves fell to their lowest level since 1979. In addition, AGA in its "1986 Base Case" for gas supply and demand, issued before the 1986 collapse in world oil prices, has projected that under current wellhead price regulations, exploratory oil and gas drilling activity in the lower-48 states will continue to fall from approximately 11,000 wells in

[67] EIA, "An Analysis of Natural Gas Contracts, Volume I: Old Interstate Gas," *Service Report*, Table 3 (February 1986) (RNGD-86-01) (hereafter "EIA Old Gas Study").

[68] EIA Old Gas Study, *supra*, at Table 4.

[69] *Public Service Commission of New York v. Mid-Louisiana Gas Co.*, 463 U.S. 319, 330-1 (1983); Joint Explanatory Statement of the Committee on Conference, H.R. 5289, Natural Gas Policy Act of 1978, at 67.

1985 to under 8,000 in 1995 and under 7,000 by the year 2000. The result, according to AGA, will be a precipitous decline in lower-48 conventional natural gas reserve additions from over 15 Tcf in 1985 to under 11 Tcf in 1995 and 10 Tcf by the year 2000. In other words, AGA projects, under current wellhead prices, "the combined effect of falling discoveries and more stable extensions and revisions is a reduction in the level of total reserve additions of 41 percent between 1985 and 2000." [70] The gap between domestic conventional reserve additions an imports and unconventional sources, according to AGA, will grow from 4 percent of supplies in 1985 to 20 percent in the year 2000, under current wellhead regulations.

AGA has recently updated its "1986 Base Case" projections to reflect substantially lower oil prices.[71] According to the update, lower wellhead natural gas and oil prices will reduce future exploratory drilling activity by an additional 8 percent if oil prices average $20 per barrel; and by an additional 20 percent if oil prices average $15 per barrel, compared with the "1986 Base Case" assumption of $25 per barrel. These lower levels of drilling activity, says AGA, could reduce future gas reserve additions by an additional 6 percent in the $20 per barrel case and by 17 percent in the $15 per barrel case. In other words, the bad news for future drilling prospects in the "1986 Base Case" only gets worse in AGA's update.

7. The New Just and Reasonable Ceiling Price

In setting a new single just and reasonable ceiling price for all vintages of old, flowing gas, the Commission has considered a number of factors.

[70] Initial Comments of American Gas Association, Appendix B attaching "A.G.A.-TERA BASE CASE 1986-I" (hereafter "AGA 1986 Base Case"), Docket No. RM 86-3-000.

[71] "AGA Analysis Shows Effect of Oil Prices on Natural Gas Sales," *Washington Letter* (American Gas Association, April 18, 1986) at 5-6.

The Commission has determined that the new ceiling price should be set at the *replacement* cost of old, flowing gas, not its *original* cost. The Commission is obligated under the NGA to assure consumers long-term reliable gas service at reasonable cost. To the extent original-cost rates do not reflect the replacement cost of depleted reserves, such rates fail to assure adequate supply and therefore fail to fulfill the goals of the NGA. In addition, original-cost rates represent, in part, an effort by previous Commissions to keep *old* gas rates artificially low, in order to offset any immediate increases in consumer prices due to higher *new* gas rates. These efforts did not prevent gas shortages before the enactment of NGPA, and the NGPA itself has removed the Commission's jurisdiction to increase new gas rates. For all these reasons, the Commission concludes that it should not use original cost methodology as a "back-door" means of keeping old gas prices artificially low in order to offset the higher, market-based prices for new gas mandated by the NGPA.

However, the Commission's authority over old gas ceiling prices under the NGPA is limited to *raising*, *not lowering* such ceiling prices. In addition, *any* effort to define the current "replacement cost" of gas must take into account the distortions and disorders which already exist in gas markets today. Therefore, the Commission cannot unduly rely on price signals in those markets as an absolutely accurate measure of "replacement cost." Finally, the NGPA itself constitutes a finding that wellhead markets are workably competitive, but gives the Commission little guidance—besides the NGA "just and reasonable" standard—on how to exercise its own NGPA discretion to raise old gas ceiling prices beyond their previous, primarily original-cost based levels. The highest numerical level set by the NGPA for old gas ceiling prices is that for the post-1974 vintage, currently $2.57 per MMBtu.

Third, the Commission's NGPA discretion permits it to mitigate, but not entirely eliminate, disparities in gas prices. It can only set new ceiling prices for old gas under NGPA sections 104, 106, and 109, and cannot revise the maximum lawful price ceilings for gas still regulated under sections 102, 103, 105, and 108. Nor can it set rates for old gas; it can only set maximum lawful ceiling prices for purposes of the NGPA. Thus, any new ceiling prices for old, flowing gas will not eliminate all price distinctions between old gas, still-regulated new and high-cost gas, and deregulated gas.

Fourth, recognizing the difficulties in calculating the erplacement cost of gas, the Commission has considered a range of other wellhead prices as criteria for a just and reasonable ceiling price. For example, the Commission notes the current conditions in gas markets, where spot gas prices are below $2 per Mcf, and "market-responsive" contracts are not getting much more.[72] It also notes that pipeline WACOGs are still averaging in the $2.50 range, long-term contract prices for new gas are in the same range, and oil and gas drilling has collapsed in response to plummeting energy commodity prices.[73] This collapse in drilling, coupled with declining reserve replacement in 1985, indicates current short-term prices for gas are actually below the long-term replacement cost of gas, thereby undermining incentives to drill for new supplies. Finally, the Commission has also reviewed these long-term downward trends in reserve replacement, and notes that the existing proved reserve base reflects a mixture of already-

[72] *E.g.*, "Spot Gas Prices Down," *The Energy Daily* (May 6, 1986), p. 1 (citing spot gas wellhead prices ranging between $1.35/MMBtu and $1.70/MMBtu on eight interstate pipeline systems for contracts of 1-6 months duration).

[73] *See Natural Gas Month*, *supra*, Table 5; "An Analysis of the Department of Energy's Notice of Proposed Rulemaking (NOPR), 'Ceiling Prices: Old Gas Pricing Structure,'" *Service Report*, EIA, May 1986 at figure 1-4 (RNGD-86-03). The ail and gas active rotary rig count was 757 for the week ending May 19, 1986.

discovered old gas fields and new gas fields yet to be developed in expensive frontier areas such as the outer continental shelf (OCS).[74]

For these reasons, and as discussed in more detail herein, the Commission has determined that the just and reasonable ceiling price is within a "zone of reasonableness" which represents the current replacement cost of gas established in Part IV, *infra*.

Within this range, the Commission has also determined that a new single just and reasonable ceiling price for all vintages of old, flowing gas should be no higher than the lowest price in the range of replacement cost, the current $2.75 per MMBtu price for post-1974 flowing gas, escalated for inflation. This ceiling price is within the zone of reasonableness for replacement cost, but is no higher than the highest vintage rate Congress itself retained for flowing gas under the NGPA. This price is the minimum necessary to permit producers to recover the cost of capital to replace depleted reserves over the long-term. Because this price does not exceed the highest cost-based price set by Congress for old gas, it is also a price which protects consumers against exploitation by producers inconsistent with the competitive conditions in wellhead markets, mandated by the NGPA. As natural gas markets evolve further under competitive conditions, the Commission will review this new national ceiling price to assure that it remains within the zone of reasonableness for replacement cost.

Furthermore, as an integral part of the new ceiling price itself, the Commission is adopting a "good faith

[74] See generally, U.S. Natural Gas Availability: *Gas Supply Through the Year 2000* (Washington, DC: U.S. Congress, Office of Technology Assessment, (OTA-E-245, February 1985) (hereafter "OTA Report"); AGA Gas Supply Committee, "Conventional Natural Gas Production in the Lower-48 States Through 2010," *Gas Energy Review* (Vol. 13, No. 11, American Gas Association, November 1985) (hereafter "AGA Gas Supply Committee Report").

negotiation" procedure which prevents any producer from automatically collecting a higher price under an existing contract unless a purchaser expressly agrees and unless the producer is willing to renegotiate certain other gas contracts the purchaser considers non-market responsive. Finally, in order to protect a pipeline's firm sales customers from any adverse impacts on their existing gas services, the new ceiling price provides such customers a right of first refusal and transportation authority for gas released by a pipeline under the good faith negotiation procedure. The implementation of the good faith negotiation procedure itself is delayed until November 1, 1986 in order to permit voluntary price renegotiation before any gas is released under the rule.

III. Summary of the Rule Adopted

The rule adopted today by the Commission represents an endorsement of the objectives set forth in the DOE proposal, modified to recognize the current needs of the natural gas market for regulatory change and the most practical means of meeting those needs. Before specifically addressing the issues presented by comments in the record, the Commission offers the following summary of the changes in its regulations that will become effective July 18, 1986.

Part 271 of the Commission's regulations governs ceiling prices for all categories of natural gas. It includes a table (§ 271.101(a), Table II) that specifies the maximum lawful prices (MLPs) for all vintages of gas subject to NGPA sections 104 and 106(a). Subpart D of Part 271 implements the NGPA's maximum lawful prices for old gas sold in interstate commerce, namely, gas subject to NGPA sections 104 and 106(a). Subpart F implements those prices for old gas sold under intrastate rollover contracts, if the gas is not otherwise deregulated. This gas is subject to NGPA section 106(b).

The new rule provides an alternative MLP for all vintages of gas under NGPA sections 104 and 106 at the

price set forth in Table II for post-1974 gas, currently $2.57 per MMBtu, subject to an inflation factor adjustment. The Commission amends § 271.402(c) to make available the higher MLP for sections 104 and 106(a) gas as an alternative to the otherwise applicable vintage prices. A producer of sections 104 and 106(a) gas may collect a price up to the alternative MLP if the price is established under a contract provision executed by the purchaser after July 18, 1986, or the purchaser has agreed to pay a higher price under the terms of an existing contract. Therefore the rule precludes the automatic effectiveness of indefinite price escalator clauses in existing contracts and ensures that a purchaser will not be obligated to pay the higher price after promulgation of this rule unless it agrees to continue purchases under an existing contract.

Under § 271.602, which pertains to MLPs under intrastate rollover contracts, the Commission also allows collection of the MLP listed for post-1974 gas in Table II, if it is higher than the older available prices specified, but only if the price is established under a contract provision executed after July 18, 1986.

The final rule also establishes a good faith negotiation procedure under a new § 270.201. The negotiation procedure is available to a producer whose interstate contract provides for escalation of the contract price to a higher MLP. This negotiation rule grants producers abandonment if the producer seeks a higher price for its old gas, is unable to agree with the purchaser on a suitable price, and finds another purchaser. If the tentative new purchaser is not a firm sales customer of the existing purchaser, and the existing purchaser is not an open-access transporter under Order No. 436, firm sales customers of the existing purchaser have a right of first refusal. The rule applies to renegotiations of the price for sales under contracts in effect on the effective date of the rule as well as sales made under certificates of

public convenience and necessity where the underlying contract has expired. However, formal negotiations under the rule may not begin prior to November 1, 1986. The abandonment provisions of the rule are not available for gas sold under interstate contracts that do not provide for escalation of the contract price to a higher MLP or for gas sold under intrastate rollover contracts. However, the price of gas sold under such contracts may be increased up to the new higher MLP if the producer can nevertheless secure the purchaser's agreement to a higher price.

Producers will be granted blanket certificates of public convenience and necessity authorizing the sale of gas abandoned under the provisions of this rule, as well as authority to abandon future sales of such gas upon termination of the contract. The rate filing requirements for sales of such gas under existing regulations are waived. However, producers will be required to report annually to the Commission on their jurisdictional sales of gas abandoned pursuant to this rule.

Interstate pipelines that are not open-access transporters under the provision of Order No. 436 will be granted blanket transportation certificates and will be deemed to have agreed to deliver on behalf of any shipper any gas released under this rule to any of its existing customers or interconnected pipelines. Pipelines will not become open-access transporters by virtue of transportation performed under the blanket certificate.

The mechanics of the good faith negotiation rule are as follows. The producer may, at any time after October 31, 1986, request in writing that the purchaser nominate a price it is willing to pay for the producer's old gas. Such a request constitutes an offer by the producer to release the purchaser from its obligation to continue purchasing gas subject to price renegotiation under the good faith negotiation rule. If the purchaser does not respond within sixty days, the producer may enter into a written

contract for the sale of the gas to a new purchaser, subject to a right of first refusal by firm sales customers of an existing purchaser which is not an open-access transporter under Order No. 436, and thereafter abandon sale of the gas to the existing purchaser upon 30-days' written notice. However, if the purchaser responds by offering the highest price permitted under the existing or expired contract up to the alternative MLP, the producer must accept the offer and continue to sell the gas to the purchaser.[75] Alternatively, the producer may accept or reject any price offered below the highest price permitted. If the producer accepts, sales continue at the agreed-upon price. If the producer rejects the offer and enters into a written contract with another purchaser, the producer is granted abandonment.

The interests of purchasers are protected by permitting them to request the producer to nominate a price at which it will continue to sell any gas being sold under any contract sought to be renegotiated by the producer as well as any gas under any or all contracts with that producer which provide for the sale of any old gas. If the purchaser rejects the price nominated by the producer, the purchaser may accept the producer's offer of a release and terminate its contractual obligation to take the gas after 30-days' notice. Once the purchaser discontinues purchasing the gas, terminating its contractual obligation under authority of this rule, the producer is granted authority to abandon sale of the jurisdictional gas to the purchaser.

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[75] An offer of the highest permitted price must conform to all other terms of the contract. A purchaser may not, for example, preclude the producer's rejection by offering the highest permitted price for only a portion of the volume of takes required by the contract. If a contract with an indefinite price escalator clause has been superseded by a contract amendment imposing a temporary cap on the price of the gas, the highest permitted price would be the temporary cap until expiration of tht amendment and, thereafter, as provided by the indefinite price escalator clause.

The right to renegotiate under this rule, with the attendant rights of abandonment and contract termination, are available only once for each contract. If a producer has initiated negotiations under the good faith negotiation rule, or the producer and purchaser have agreed on the price of gas after July 18, 1986 whether or not after negotiations in accordance with the rule, the abandonment and contract termination rights are not subsequently available for any gas sold under the contract in question. However, nothing in the rule precludes the parties from thereafter negotiating mutually agreeable revisions in price or other terms of their contracts.

IV. Raising the Maximum Lawful Price for Old Gas

A. *Scope of Commission Authority*

The Commission's adoption of the old gas proposal is predicated on the exercise of its authority under sections 104(b)(2) and 106(c) of the NGPA. These sections provide that the Commission may prescribe a maximum lawful price for any first sale (or category thereof) which is higher than the otherwise applicable price, provided the higher price is "just and reasonable within the meaning of the Natural Gas Act." [76] DOE argues that the Commission has wide discretion to establish the structure as well as the level of just and reasonable rates for old gas consistent with applicable standards and precedent developed under the NGA, including authority to

[76] The text of section 104(b)(2) is as follows:

(2) Ceiling prices may be increased if just and reasonable—

The Commission may, by rule or order, prescribe a maximum lawful ceiling price, applicable to any first sale of any natural gas (or category thereof, as determined by the Commission) otherwise subject to the preceding provisions of this section if such price is—

(A) higher than the maximum lawful price which would otherwise be applicable under such provisions; and

(B) just and reasonable within the meaning of the Natural Gas Act.

eliminate vintaging of old gas and to consider both cost and non-cost factors in establishing ceiling prices.

In the notice of December 20, 1985, the Commission requested comments concerning its legal authority to establish new just and reasonable rates under NGPA sections 104 and 106. The Commission noted that the cost-based methodologies used in the past to establish just and reasonable rates were developed in the context of different market conditions which were not competitive and a different regulatory framework from that which exists today. The Commission requested comments concerning the legal and practical effects of using prior methodologies and the extent to which the Commission may rely on non-cost factors in determining just and reasonable rates. The Commission also expressly requested the commenters to include quantitative as well as qualitative analyses of the legal, policy, economic and technical issues raised in the DOE proposal.

Comments. Numerous opposing commenters argue that the old gas proposal is beyond the scope of Commission authority and therefore cannot be lawfully adopted. Their position is that Congress, acting through the NGPA, has established a permanent, unalterable pricing system for old gas and that the Commission's authority to raise rates under NGPA sections 104(b)(2) and 106(c) is limited to adjustments that reflect increases in costs that are not adequately compensated for by the NGPA's inflation adjustments, or on a case-by-case basis, where production has become uneconomic under existing prices.[77] Opposing commenters also cite certain legislative history as authority for the proposition that Congress did not

[77] Maryland People's Counsel—National Association of State Utility Consumer Advocates (MPC-NASUCA) at 3-7; New York Public Service Commission (New York) at 3-13; *see also* California PUC at 5-12; Arkansas PSC at 4; PSC of Wisconsin at 2-5; PSC of West Virginia at 6-9; PSC of Kentucky at 1-4; PSC of District of Columbia at 2-9. (Unless otherwise indicated, all references to comments above and hereinafter are to initial comments.)

contemplate that the Commission could or would apply a different just and reasonable standard than that underlying the 1977 benchmark prices incorporated in the NGPA as the ceiling prices for old gas.[78]

Commission Response. The Commission rejects the arguments of the opposing commenters and concludes that there is ample authority under the NGPA for the Commission's adoption of the old gas proposal. The express and unambiguous terms of the statute specifically authorize the Commission to raise old gas prices, subject only to the requirement that the Commission find that the higher rates are just and reasonable within the meaning of the NGA.

The Commission is not persuaded by the excerpts from the Senate and House debates on the NPGA cited by MPC-NASUCA [79] that Congress intended to forever keep the price of old gas at an absolute minimum. The Commission can discern no basis in the NGPA's legislative history for concluding that Congress intended to foreclose the Commission's ability to consider changes in the old gas price structure such as those proposed by DOE or to otherwise limit the Commission's authority under the NGA to establish just and reasonable rates for old gas. Indeed, the NGPA's legislative history leads to the conclusion that Congress fully understood the broad scope of Commission authority to establish regulated wellhead prices under the NGA.[80] While Congress' decision to leave old gas under the largely cost-based ceilings of NGA regulation was clearly intended to mitigate the effects of allowing higher prices for new gas, the Commission was not precluded from achieving the same result

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[78] New York at 3-13.

[79] MPC-NASUCA at 3-7.

[80] *See* statements of Senators Jackson, 124 Cong. Rec. 28,633 (Sept. 11, 1978); Abourezk, 124 Cong. Rec. 30,018 (Sept. 19, 1978); and Kennedy, 124 Cong. Rec. 30,023 (Sept. 19, 1978).

by different methods, such as reliance on replacement cost and good faith renegotiation requirements as in this rule, provided the end result is just and reasonable.

The NGPA incorporated the just and reasonable rates established by the Commission in Opinion Nos. 749 and 770-A, plus an adjustment for inflation. Sections 104(b)(2) and 106(c) also provided the Commission with authority to increase maximum lawful ceiling prices above those levels if the increased prices are just and reasonable within the meaning of the NGA. The Commission may exercise this authority by rulemaking or on case-by-case basis.[81] The just and reasonable standard of the NGA is not, however, precise and rigid. The standard has been interpreted by the Commission and the courts to permit consideration of many non-cost factors in establishing just and reasonable rates.[82] These non-cost factors have included market forces, the need to stimulate production, alternative fuel prices, current exploration and development needs, and competitive conditions in wellhead markets. Factors that may be significant in determining just and reasonable rates in an era when gas supplies are scarce and competition virtually nonexistent are less significant now when those conditions are reversed. Thus, the studies presented by AGD, recalculating current ceiling prices with the methods employed by the FPC in the mid-1970's, do not necessarily establish just and reasonable price ceilings under present conditions.

MPC-NASUCA cite comments by Senator Domenici allegedly demonstrating that the NGPA was intended to preclude administrative elimination of the vintaging of old gas.[83] However, the statement on its face refers to

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[81] Wisconsin Gas Co. v. FERC, 770 F.2d 1144, 1153 (D.C. Cir. 1985).

[82] *See infra* at 84-92.

[83] The statement relied on is as follows: "I am saying that [elimination of vintaging] is not in this bill, that is not doable. No one has even suggested deregulating old gas. That is what I

legislative deregulation of natural gas prices, *not* the *regulatory* revision of ceiling prices under NGPA sections 104(b) and 106(a). On April 11, 1985, Senator Domenici transmitted to the Commission a letter disavowing MPC-NASCUA's interpretation of his 1978 floor statements concerning the NGPA.[64] In his letter, Senator Domenici states as follows:

> While I did refer to "vintaging", the reference was solely in the context of stating that the legislation at hand did not remove price regulations on old gas. My reasons were as stated—the politics of the Congress in 1978 simply did not permit total deregulation. However, I did not intend—nor did Congress intend in passing the NGPA—to alter existing law with regard to the Commission's complete discretion over vintaging.
>
> It is my own belief that vintaging has been and continues to be a matter of policy for and by the Commission. That was the law under the NGA, and that was the state of the law at the time Congress adopted the NGPA. As such, the Commission is free to change it—or even terminate it—at the option of a majority of the Commissioners. Nothing in the legislative history and particularly nothing in my own statements, can be read to inhibit the Commission if it chooses to exercise that freedom in the current [RM86-3-000] proceeding.

In light of this letter and numerous cases upholding decisions of the Commission to phase-out or reinstitute vintaging, the Commission concludes that whether or to what extent vintaging should be continued and old gas

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was referring to as being not doable." 124 Cong. Rec. 28,865 (Sept. 12, 1978).

[64] The Commission has included the letter in the record of RM86-3-000.

rates revised is a matter within its discretion.[65] Thus the Commission concludes that there is no question of its authority under the NGPA to adjust old gas MLPs under the just and reasonable standards on the basis of non-cost factors, and to eliminate vintaging if circumstances so warrant. The real issue presented, therefore, is whether the Commission should exercise its authority in the manner proposed by DOE.

B. *Deficiencies in Old Gas Price Structure*

DOE asserts that the existing old gas price structure is "woefully outmoded,"[66] characterized by "distortions, inequities, inefficiencies and disincentives,"[67] and thus demands reform. Noting that it has been nine years since the last national ratemaking was completed, DOE argues that the economic data and information concerning replacement costs, commodity values, and other factors which were considered by the Commission in formulating the old gas prices have been overtaken by events.[68]

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[65] Shell Oil Co. v. FPC, 491 F.2d 82 (5th Cir. 1974) (FPC's decision to permit gradual phase-out of vintaging is "rational, reasonable and therefore fully permissible," Shell Oil Co. v. FPC, 520 F.2d 1061 (5th Cir. 1975), *cert. denied*, 426 U.S. 941 (1976) (Commission not bound by its previous policies on vintaging and has latitude to evaluate old experiments and modify or abandon them in its best judgment); Tenneco Oil Co. v. FERC, 571 F.2d 834 (5th Cir. 1978), *cert. denied*, 439 U.S. 801 (1978) (Commission's decision to reinstitute vintaging and ignore the cost of replacing flowing gas is within the Commission's discreton to balance policy considerations); Mobil Oil Corp. v. FPC, 417 U.S. 283 (1974) (Commission could raise maximum lawful rates for old gas even without new evidence of cost of that gas in order to spread burden of cost of producing new gas to all users).

[66] DOE Notice of Proposed Rulemaking (DOE Proposal) 50 FR 48540 (Nov. 25, 1985).

[67] DOE initial comments at 2.

[68] DOE Proposal, 50 FR at 48541.

DOE's principal criticisms of the existing price structure are that it (1) results in inefficient production and the permanent loss of old gas reserves, (2) distorts the market, harming both producers and consumers, and (3) is illogical and unnecessarily complex.

On the issue of production, DOE relies on studies showing that if current old gas prices are held at their present levels, approximately 11 Tcf of old gas reserves will be permanently lost. DOE argues that domestic gas which is not produced as a result of vintaging may be replaced by foreign imports of both oil and gas that are higher in price or quality than necessary, and that the nation's energy security would thereby be compromised and the trade balance weakened.[89]

Concerning the issue of market distortion, DOE states that the Commission and the courts have recognized the inequity and discrimination between customers arising as a consequence of separately vintaged pricing for old and new gas.[90] According to DOE, this inequity has evolved as the rates for old gas were no longer able to recover a reasonable share of the cost of developing new reserves to replace the old gas being consumed. DOE reasons, however, that any presumed benefits to consumers of old gas are illusory, since their interest in secure long-term supply is not furthered, and the overall price they pay is not reduced since higher-cost gas is rolled into the pipeline's supply mix.[91]

DOE also argues that the differences between new and old gas prices as well as among old gas vintages are anomalous and excessive. Under the Permian Basin and Southern Louisiana area rate proceedings, the ratio be-

[89] *Id.* at 4; *see also*, Secretary Herrington's Comments, April 10, 1986 Hearing in Docket No. RM86-3-000, Transcript at 5-7.

[90] DOE Proposal, 50 FR at 48541, *citing* Tenneco Oil Co. v. FERC, 571 F.2d at 839.

[91] *Id.* at 48,541.

tween new and old gas ceiling prices was less than 1.2 to 1, whereas today the ratios between new gas ceiling prices under NGPA sections 102 ($4.26) and 103(b)(2) ($3.68) and ceiling prices for pre-1973 old gas ($.52) are about eight to one and seven to one respectively. The ratio between the post-1974 ceiling price of $2.57 and the pre-1973 ceiling price is approximately five to one; the ratio between current spot market prices (roughly $2.00) and the pre-1973 price is about four to one. DOE argues that these differences in prices for a fungible product such as natural gas serve no useful economic purpose.[92] DOE also argues that the existing old gas pricing system, made up of some fifteen separate old gas vintages (including minimum rate gas), is overly and unnecessarily complex as well as administratively unwieldy.

DOE recommends judging the justness and reasonableness of NGPA old gas prices on the four criteria employed by the Commission in its notice requesting supplemental comments on Part D, the block billing proposal, issued on October 9, 1985, in Docket No. RM85-1-000.[93] Under these standards, a just and reasonable rate must (1) permit efficiency in production and consumption of natural gas;[94] (2) permit fair competition;[95] (3) pre-

[92] The Permian Basin and Southern Louisiana area ratemakings established but a single rate for old gas; Opinion No. 749 (the "minimum rate" case) collapsed area rate vintages into a single national rate for flowing gas; and the first national proceeding allowed a single new gas price when old gas contracts rolled over, thereby collapsing various old gas prices into a new single price. *See id.* at 48,542, *citing* Shell Oil Co. v. FPC, 520 F.2d at 1077.

[93] 50 FR 42372 (October 18, 1985).

[94] That is, the price for natural gas in a given market should reflect the resource cost of bringing that natural gas into that market.

[95] Such competition, whether between pipelines or between a pipeline and a competing fuel supplier (such as gas, oil, coal, or electricity), should reflect the *current* decisions and efficiencies with which those suppliers operate and should not be distorted by the effects of decisions that proved to be wrong or right in past years.

vent wasteful depletion;[96] and (4) respond to changing conditions in the industry.[97] DOE concludes that current old gas prices fail to meet any of these standards and are therefore not just and reasonable.

DOE concludes that many of the problems identified by the Commission in Docket No. RM85-1-000 (Part D) result primarily from the structure of old gas prices and not from rolled-in pricing, and that those problems would be resolved by replacing vintaging with a uniform ceiling price based on replacement costs and other relevant factors. That price, according to DOE, is the ceiling price for post-1974 gas.

Comments. Producer commenters[98] and producing states[99] support DOE's position that old gas vintaging at artificially low prices is a principal cause of current market distortions. Such distortions, they say, include wide disparities in city-gate prices on different pipeline systems, the ability of pipelines to maintain above-market prices for some gas by rolling it in with low-priced old gas, and inaccurate price signals to consumers of the true replacement cost of the gas they consume. Indicated Producers and NSGA support DOE's analysis of deficiencies in the old gas price structure with their own legal and economic analyses. Indicated Producers argue that neither the Commission nor the courts have con-

[96] That is, consumers should not be encouraged to use up supplies of natural gas whose value to them is less than the cost of making those supplies available.

[97] Thus, rates for natural gas should not inhibit the growth of competition envisioned by the NGPA, and should permit, for example, the full benefits to be derived from the optional expedited certificate procedures established in Order No. 436.

[98] *See, e.g.*, NGSA at 7-22; Indicated Producers at 15-29; Independent Petroleum Association of America (IPAA) at 5; Independent Petroleum Association of Mountain States at 1-2.

[99] Interstate Oil Compact Commission at 2-4.

sidered vintaging to be an intrinsic part of just and reasonable rates under the NGA. NGSA supports its position with a comparative analysis of block billing and market pricing of old gas.[100] Process Gas Consumers Group (PGC), an association of industrial consumers of natural gas, also supports the old gas proposal as likely to reduce the market distortions arising from remaining wellhead price controls as does the Fertilizer Institute, representing agricultural consumers.[101]

Pipeline and distributor commenters, as well as certain state commissions argue that the proposed rule erroneously targets old gas prices as economically inefficient and a source of market disorder. Interstate Natural Gas Association of America (INGAA), for example, disagrees with DOE's analysis and argues that the proposed rule would do nothing to address the "overarching" problem of high-price/high-take contracts and that the DOE proposal "increases the likelihood of market distortions, since the high-price/high-take contract problems can be expected to worsen," if old gas prices are permitted to increase.[102]

Other opposing commenters assert that there is no factual evidence of any market distortion attributable to old gas vintaging, or that market distortions, which may have existed in the past, are no longer present. United Distribution Companies (UDC), for example, states that

[100] This study, prepared by Prof. Joseph P. Kalt of Howard University, discusses the distorting effects of below-market pricing and how this creates a cushion to subsidize the otherwise uneconomic development of high-cost gas. Professor Kalt argues that vintage pricing inhibits development of low-cost supply sources and stimulates prematurely higher-cost supply development, and that the benefits of the existing structure accrue chiefly to high-cost gas producers and not to the consuming public as a whole.

[101] PGC at 3. PGC finds a shortcoming in DOE's proposal, however, in that it does not link increases in old gas prices to reductions in high-priced new gas.

[102] INGAA at 4-5.

while DOE alleges there are market distortions caused by the current pricing structure applicable to old gas, the "specific factual bases for these contentions are not identified . . ." [103]

Commission Response. Upon consideration of all of the comments and views with regard to alleged deficiencies in the old gas structure, the Commission concludes that serious distortions remain in the natural gas markets and that these distortions emanate primarily from the old gas vintage price structure. This is not a new insight. Beginning with the Notice of Inquiry in Docket No. RM82-26-000, and more recently in the Docket No. RM85-1-000 (Part D) proceedings, the Commission has grappled with the problems arising out of the old gas price structure, either directly or indirectly. The Commission has long recognized distortions and deficiencies in the old gas pricing system. Thus, the DOE proposal is the culmination of a long period of Commission review of the problem of the old gas price structure in prior proceedings.

In Docket No. RM82-26-000, for example, the Commission issued its notice of inquiry on the impact of the NGPA on current and projected natural gas markets.[104] The central purpose of the notice of inquiry was to gather information on the existence of market distortions due to rolled-in pricing of old and new gas supplies and to study recommendations that the Commission revise the prices of old flowing gas to eliminate the distortions.[105] More

[103] UDC at 3.

[104] 47 FR 19157 (May 4, 1982).

[105] In its Notice of Inquiry, at Appendix A, Docket No. RM82-26-000, the Commission noted two reasons why the elimination of vintaging may be appropriate: (1) "[T]he elimination of vintaging may be appropriate because, combined with partial decontrol, it may be a major factor exacerbating the market ordering problem." * * * (2) "[V]intaging may discriminate unreasonably against customers of pipelines that have a much smaller price cushion. . . . This advantage is the result of a pipeline's historical,

recently, in the block billing proposal in Docket No. RM85-1-000 (Part D),[106] the Commission proposed to remedy the continuing market imbalances but only indirectly, without affecting the root cause of these imbalances—the old gas pricing structure.[107] The record in the present proceeding confirms the inadequacy of the old gas price structure, and the continuing necessity to act on it. For example, the price disparities engendered by it have led to the continued failure since the NGPA to achieve replacement of reserves equivalent to demand, as would occur in an economically rational market.[108] Also, the old gas cushion has failed to keep burner tip prices competitive with oil. Rather, as the wellhead price of gas has rapidly plummeted to remain competitive, city-

fortuitous opportunities to contract for large volumes of low-priced vintaged gas and bears no rational relationship to its customers' demands or priority uses." FERC Stats. and Regs. ¶ 35,512, at 35,574. Thus the DOE old gas proposal was presaged almost exactly by the Commission in the Notice of Inquiry.

[106] 50 FR 42408 (October 18, 1985); 50 FR 45,907 (November 5, 1985).

[107] The block billing approach eschewed adjustment of the old vintages, partly as a result of an implicit narrow reading of the Commission's authority to set just and reasonable rates under NGPA sections 104(b)(2) and 106(c). Analysis of the DOE proposal and the comments generated by it leads the Commission to conclude that its discretion under sections 104 and 106 is wide enough to allow the Commission to collapse the old gas vintages, thereby directly attacking the source of distortions. As has been pointed out, Congress in Title I intended to treat gas producers as a naturally competitive sector, and the DOE proposal permits market forces to work in that competitive sector on old gas, while keeping within the bounds of a price ceiling circumscribed by the just and reasonable replacement cost of the commodity. *See, e.g.*, Pennzoil Co. v. FERC, 645 F.2d 360, 378-79 (5th Cir. 1981) ("Congress apparently decided that gas producers do not have 'natural' monopoly power") *cert. denied*, 454 U.S. 142 (1982); *see also* NGSA at 9-12.

[108] *See e.g.* Initial Comments of AGA, Appendix B, "AGA-TERA BASE CASE 1986-I" (AGA projects under current well-

gate rates have declined with disproportionate slowness, due in large part to the favorable access of some consumers to artificially low-priced old gas, compared to other not so fortunate consumers.[109]

We note the contention that the distorting effect of old gas prices has been dissipated. Maryland People's Counsel (MPC) for example, argues that market distortions caused by the old gas cushion are now largely dissipated, since any original advantage attributable to cushion gas has now been "used up" and prices of new gas coming on the market are now fully subject to the discipline of the marketplace.[110] Texas Gas Transmission Corporation (Texas Gas) also asserts that low prices of NGPA sections 104 and 106(a) gas are no longer skewing purchasing decisions. While agreeing that market disorders arising from the past contracting practices remain, Texas Gas argues that the remedy should be directed to the high-cost "problem" contracts rather than old gas prices. It is true that the bidding wars of the 1978-1981 period

head prices, that "the combined effect of falling discoveries and more stable extensions and revisions is a reduction in the level of total reserve additions of 41 per cent between 1985 and 2000.").

[109] The high city-gate rates have vintaging as a "root cause", because the high-cost contracts that are indirectly contributing to these rates were entered into when pipelines relied on the misleading economic signals intrinsic in the unrealistically low old gas cushion vintages to which they had access.

[110] What MPC is referring to is the "bidding war" by pipelines during the 1978-81 period of relative supply scarcity. Anxious to attach additional reserves to replenish inventories severely depleted during the curtailment era, pipelines paid maximum lawful prices for new gas and contracted for deregulated supplies at prices as high as \$8-\$10 per MMBtu. Those pipelines with larger cushions of old gas vintages were able to outbid their competitors, not on the basis of efficiency of operation and management, but solely based on the amount of "old" gas they could roll-in without adversely affecting their weighed average cost of gas (WACOG) vis-a-vis other pipelines. After 1982, most pipelines added market-out clauses in new cointracts to make them market-responsive.

are over, and that prices for new supplies on the spot market have fallen well below the levels experienced during that period and, indeed, below the highest old gas ceiling price (post-1974 vintage). But, while the bidding-up of prices for new gas, (caused in large part by reliance by purchasers on their old gas cushions) may have ended, the distorting effects of the artificially low prices established by the vintage price system remain. Once the present deliverability surplus[111] is eliminated and natural gas supply and demand come into balance,[112] new gas prices could potentially be required to bear the brunt of price increases permitted by the market, resulting in disproportionate increases in new gas prices and increased distortion in the overall price structure as between old and new gas. If vintaging is not eliminated now, the price distortions it causes will be aggravated when the surplus disappears and bidding on new gas supplies accelerates.

Because NGPA sections 104(b)(2) and 106(c) expressly authorize the revision of old gas ceiling prices, the Commission need not find existing old gas price ceilings unjust and unreasonable under the NGA in order to change them. However, insofar as the existing old gas price structure *is* unjust and unreasonable within the meaning of the NGA, because of the continuing distortions on prices and reserve replacement it engenders, it

[111] The Commission has recognized a surplus of gas available for delivery amounting to between 1 and 4 Tcf or an annual basis. Notice Requesting Supplemental comments, RM85-1-000 (Part D) 50 *Fed. Reg.* at 42,383; AGA estimates excess production capacity at between 2.5 and 2.8 Tcf in 1986. AGA, Appendix A, at 3.

[112] DOE estimates that under its old gas proposal, surplus deliverability will be reduced to between 1-2 Tcf at the end of 1986, and will be totally dissipated during 1987. Without adoption of its proposal, the surplus will not be dissipated until 1989, at which time, if vintages persist, bidding up of deregulated gas may be renewed and drilling budgets inefficiently allocated to those marginal supply prospects with the highest per unit price, rather than those with the highest value in terms of additions to reserves. DOE at 13.

must be changed pursuant to the authority vested in the Commission by Congress.[113] There is no legislative mandate for permanent vintaging. The history of vintage pricing supports this conclusion. The history of vintaging in producer regulation under the NGA commenced with the original Statement of General Policy No. 61-1,[114] in which the Federal Power Commission (FPC) outlined its plan for establishing area rates. In the Statement of General Policy No. 61-1, the FPC, while establishing separate schedules for initial prices in new contracts and increased prices in existing contract, stated that "[i]t is anticipated that these differences in price levels will be reduced and eventually eliminated as subsequent experience brings about revisions in the prices in the various areas." [115] The Commission subsequently acted to eliminate vintaging in Opinion No. 639 (Appalachian Area Rate Proceeding) stating that "[w]e believe vintaging to be an anachronism which we should now move to eliminate," [116] and Opinion No. 699-H [117] (first nationwide rate proceeding), and these decisions were affirmed by the Courts.[118] Vintaging was subsequently reestablished by the Commission in Opinion Nos. 770 and 770-A and has remained in effect since then.

Since vintaging is the major cause of the market distortions identified by the Commission in Docket No.

[113] *See* Wisconsin Gas Co. v. FERC, 770 F.2d 1144 (D.C. Cir. 1985).

[114] 24 FPC 818 (1960).

[115] *Id.* at 819.

[116] 48 FPC 1299, at p. 1309 (1972).

[117] 52 FPC 1604 (1974). *See also*, Opinion No. 749, 54 FPC 3090 (1975).

[118] Opinion No. 699-H, *aff'd sub nom. Shell Oil Co. v. FPC*, 520 F.2d 1061 (1975), *cert. denied sub nom. California Co. v. FPC*, 426 U.S. 941 (1976); Opinion No. 749, *aff'd sub nom. Tenneco Oil Co. v. FERC*, 571 F.2d 834 (1978), *cert. dismissed*, 439 U.S. 801 (1978).

RM85-1-000, the current problems being experienced in natural gas markets would largely be remedied by collapsing vintages and raising ceiling prices of below-market priced gas. The elimination of vintages, as necessitated by market trends, is not a total departure from past practice. Congress' grant to the Commission in sections 104(b)(2) and 106(c) allowing increased ceiling prices to be established if just and reasonable must be understood in this historical context.

The evidence in this proceeding demonstrates that existing old gas prices prevent fair competition because pipelines and distributors with proportionately greater access to low-priced old gas are placed in an advantageous competitive position in acquiring and marketing supplies relative to those pipelines and distributors with less access to cushion gas. MPC has argued that the unfair advantage given certain pipelines by their old gas cushion has been expended through the process of bidding-up the price of deregulated gas. However, the old gas cushion *continues* to distort downstream markets by providing an unfair competitive advantage to some pipelines.[119] The field WACOGS of interstate pipelines continue to be related to the size of their old gas cushions.[120] Indicated Producers provide a relatively detailed analysis of the impact of the old gas cushion on pipelines' competitive positions that rebuts MPC's argument.

Indicated Producers' analysis includes an index to measure a company's relative old gas cushion by accounting for both the old gas percentage of its total field purchases and the average price paid for old gas. The index is computed by dividing the old gas percentage by the old gas price for each pipeline and then dividing this

[119] *See* Indicated Producers reply comments at 16-20, rebutting MPC comments at 14-15.

[120] *See* Indicated Producers reply comments, Appendix E at 18, chart 2.

number into the composite index of 100 for the 24 pipelines. Thus, a pipeline with a cushion index of 182, would have twice the old gas cushion as a pipeline with an index of 91. This index system demonstrates the wide differences in old gas cushions among interstate pipelines, with the largest cushion (Northwest Central's) 8.8 times greater than the smallest cushion (of Florida Gas).

More importantly, these data, based on information in the Commission's public files, illustrate the distorting impact the old gas cushion has on pipelines' competitive positions. An excerpt from Indicated Producer's tabulation, (derived from PGA filings in effect as of January 1, 1986), shows the following: [121]

		Old Gas		*New Gas*		
Pipeline	*Cushion Index*	*Bcf*	*Price*	*Bcf*	*Price*	*(WACOG) Average Price*
Northwest Central	251.1	198	$0.85	102	$3.79	$1.82
Colorado Interstate	182.2	99	0.87	103	2.98	1.95
Texas Eastern	154.0	229	0.72	438	2.85	2.12
El Paso Natural	100.0	322	1.27	497	3.20	2.44
Southern Natural	97.4	141	1.39	196	3.95	2.88
Transwestern	79.6	54	1.20	129	3.19	2.60
Columbia Gas	56.6	162	1.58	424	3.64	3.07
Transcontinental	53.1	141	1.63	387	3.58	3.06
Consolidated Gas	40.3	20	1.00	123	3.80	3.41

As can be seen, El Paso and Transwestern have a 16¢ spread in WACOG even though they serve the same market and pay virtually the same price for new gas. Similarly, Southern Natural enjoys an 18¢ competitive advantage in WACOG over Transco, and can still afford to pay more for new gas than Transco. This competitive advantage has little to do with current or just operating efficiencies or any other fair measure of competition.

[121] *Id.* at 19, Table 5.

Instead, the advantage may be traced in substantial part to Southern Natural's old gas cushion index which is nearly twice as large as Transco's.

Since the pipeline's WACOG substantially affects the city-gate rates, the ultimate consumer feels the distorting effect of old gas vintages. While some consumers will pay less than the replacement cost of their gas, many more will find prices stubbornly higher than they would be if competitive forces in the field were allowed to operate at the burner-tip.

Thus the old gas price structure has become a structural source of market distortion and unfair competition since it engenders widely varying prices based on chance historical costs for a fungible commodity produced and sold in an otherwise competitive market. In reviewing the Commission's determination of area rates for the Southern Louisiana area, the court in *Placid Oil Co. v. FPC*, 483 F.2d 880, 899-900 (5th Cir. 1973) stated that:

> Natural gas is a fungible commodity as it comes from the bowels of the earth, neither severed nor identified to a particular contract. One molecule of gas flowing from a particular producer's wells in [the Southern Louisiana Area] might be ultimately piped to a large industrial factory pursuant to a 1962 contract, which under the terms of Opinion No. 598 would permit a maximum well-head price of 22.375¢/Mcf. At the same time its identical contiguous twin might cook the dinner for the famed 'little lady at the burner-tip' and, yet, yield a well-head price of 26¢/Mcf merely because it happened to be covered by a 1969 contract. It is therefore anomalous, if not downright inaccurate, to speak of 'old' gas. There is no 'old' gas. As it presses to freedom at the well-head, it is as 'new' as any other of nature's offspring. It may be 'old' in the sense that some arrangement confected long prior to its release made production possible. But if—and this can be

> no if—rates for so-called 'new' gas must carry an increment to enable the continued re-supply of this depleting commodity, this 'old' gas, indistinguishable molecularly, must carry this burden like an added atom in its carbon ring. *Cf. Ziegler v. Phillips Petroleum Co.*, (5th Cir. 1973), 483 F.2d 858.

This is exactly the Commission's view.

The Commission fully recognizes that the old gas price system is not the sole source of the problems facing the natural gas industry at this time, and that numerous commenters argue that the current problems in the natural gas market are caused primarily by non-market responsive new gas contracts. AGA, for example, states that "the DOE proposal is attacking the wrong problem. That problem, as we have said time and time again, is non-market-responsive new gas contracts." [122] Texas Gas, another example of such commenters, argues that the proposed rule will result in an increase in average gas prices and further loss of sales because of rigidities in high-cost new gas contracts. Yet Texas Gas implicitly acknowledges that collapsing vintaging will stimulate recovery of additional old gas reserves but argues this

[122] AGA at 2; *but see* AGA's endorsement of legislation deregulating old gas upon contract renegotiation or expiration p. 38, *supra*, at n.65. AGD endorses AGA's identification of non-market responsive contracts as the principal source of market disorder. *See also* ANR Pipeline Company at 2; Consumer Power Company and Michigan Gas Storage Company at 4-5; California PUC at 24; Florida Gas Transmission Company at 7; Kansas Power and Light Company at 15-16; Michigan Consolidated Gas Company at 21-22; Midwest Energy, Inc. at 4; Northern Illinois Gas Company at 18-19; Peoples Gas Light and Coke Company and North Shore Gas Company at 23; Piedmont Natural Gas Company, Inc. at 7; Questar Corporation at 7; Transwestern Pipeline Company at 7; Southern California Gas Company at 22.

additional supply is not needed now in light of current oversupply conditions.[123]

Of course, many factors have contributed to the current situation, characterized by falling wellhead market prices, unresponsive city-gate prices, fuel switching, loss of loads, and excess production and transmission capacity. Among the causes of present industry conditions is the unexpected decline in world oil prices and the related decline in prices of competing fuels derived from oil, notably, No. 6 fuel oil. The Commission is also keenly aware of the problems attributable to non-market responsive new gas contracts on pipeline systems.[124] The Commission nevertheless must reject the arguments of certain parties that any change in the old gas price structure be made subject to or conditioned upon some form of relief to purchasers from the terms of their uneconomic contracts. Such general intervention into private contractual arrangements has not been proven necessary. On the contrary, data indicate that many of these contractual difficulties are being settled by negotiation between the parties involved. (*See* discussion *infra*, pp. 147-49).

Yet the Commission can, and must, address the problems related to the old gas vintages. In this way the market itself will exert pressure on contracts outside of the ambit of the Commission's direct jurisdiction, to lessen the "spread" between high-cost contract prices and actual market prices. The Commission has addressed the question of uneconomic contracts for new gas and has provided a framework under Order No. 436's expedited

[123] *See e.g.*, MPC-NASCUA at 16, ANR Pipeline Co. at 2-3, Public Utilities Commission of the State of California at 24 and Appendix, Public Service Co. of Colorado at 6-7.

[124] *See* discussion, *infra* at pp. 146, 156-57 regarding price disparity between pre-1982 and post-1982 new and high-cost gas contracts.

abandonment procedure and the April 1985 "Take or Pay Statement of Policy" for the resolution of this problem.

The Commission believes that the natural forces of competition will resolve the issues surrounding high cost contracts. The Commission notes that substantial competition already exists at the burner-tip, and the open access to alternative supplies made available through Order No. 436 can only result in increased competitive pressure on gas prices in the future. The Commission has previously stated and reaffirms its position that problem contracts are primarily a matter for resolution between the parties involved.[125] The Commission has adopted a policy statement issued April 10, 1985, designed to facilitate that process.[126] For largely the same reasons expressed in Order Nos. 436 and affirmed in 436-A,[127] the Commission declines to go beyond the April 1985 policy statement, and has confidence that the free operation of market forces will provide a resolution of this issue.[128]

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[125] *See* Order No. 436, Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, Docket No. RM85-1-000, 50 Fed. Reg. 42,408, at 42,462-64 (Oct. 18, 1985); Order No. 436-A, 50 Fed. Reg. 52,217 (Dec. 23, 1985).

[126] Regulatory Treatment of Payment Made in Lieu of Take-or-Pay Obligations, Docket No. PL85-1-000, Statement of Policy and Interpretive Rule, 50 Fed. Reg. 16,076 (April 24, 1985), FERC Stats and Regs. ¶ 30,637 (1985).

[127] "In particular, we have no wish to upset current renegotiations. . . . Therefore, . . . we reaffirm our April 1985 Policy Statement . . . We note that pipelines have been successful in buying out past incurred take-or-pay in a number of instances. [Table omitted]." Order No. 436, 50 FR, at 42464 (October 18, 1985).

[128] *See e.g.*, the "released" gas programs undertaken by many pipelines, where their takes of system supply gas are low and where their takes temporarily released from high-cost contracts with renegotiated prices ("released gas") are extremely high. For example, Southern Natural Gas Company has applied to the Commission to release certain gas under contract between it and various producers, Docket No. CP86-277-000. The parties to the contract have agreed to release each other from their respective gas sales and purchase obligations so that the suppliers can sell the released gas to a marketing affiliate of Southern. The suppliers will credit all released gas that is sold to the marketing affiliate toward satisfying Southern's take-or-pay obligations.

In sum, the record in this proceeding demonstrates that the old gas price structure is a substantial source of market distortion causing producers to prematurely abandon easily accessible supplies, and consumers to react to misleading market signals based on chance historical costs rather than current economic efficiencies. The Commission therefore concludes that the old gas price structure is unjust and unreasonable and should be changed.

C. Proposed Old Gas Ceiling Price.

DOE proposes that the Commission establish a uniform ceiling price for old gas equal to the current price for post-1974 vintage gas and that once established that price continue to be adjusted for inflation as provided for in NGPA section 104. DOE describes the proposed ceiling price as being based on two factors, the first being the ceiling price established in Opinion No. 770 for post-1974 gas and the second being the inflation adjustment factor incorporated in the NGPA and used to adjust that price monthly for inflation commencing in April 1977.[129] DOE argues that the Commission is obliged to establish a rate which is within a "zone of reasonableness" and that this zone may be established by reference to both cost and non-cost factors as well as policy considerations.[130] DOE argues that the zone of reasonableness can expand in accordance with factors such as replacement costs, prices of alternative fuels, and competition.[131]

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[129] DOE initial comments at 26.

[130] DOE Proposal, 50 FR 48541 (November 25, 1985). *See FPC v. Conway*, 436 U.S. 271 (1976).

[131] DOE Proposal, 50 FR 48541.

DOE states that it has developed a "Two-Market Model" to analyze the natural gas market, and that the model "utilizes information on natural gas replacement costs, alternative fuel prices and wellhead price regulations to calculate market price and quantity projections for natural gas." [132] DOE states that it has used the Two-Market model to estimate that a just and reasonable price would be between $2.44 per Mcf and $2.68 per Mcf assuming oil prices of approximately $22 per barrel "in real terms from 1986 through 1990." [133] According to DOE, the model relies on replacement costs and other factors including supply, reserve and demand estimates, production-to-reserves ratios, and gas transmission and distribution costs.[134] DOE's actual price recommendation is based primarily on replacement costs with additional weight being given to current commodity values of unregulated gas supplies and alternative energy sources including No. 2 distillate, No. 6 fuel oil and crude oil.[135]

Comments. Producer commenters support the post-1974 ceiling price as being just and reasonable based on both cost and non-cost factors and consistent with prior producer rate decisions of the Commission and relevant judicial precedent. Indicated Producers argue that the Opinion No. 770 replacement cost methodology fully supports the justness and reasonableness of the proposed ceiling price. They also submit that replacement cost is the only relevant cost in a competitive industry and that the Commission has previously recognized this fact by providing in the first national rate proceeding (Opinion No. 699-H) for the uniform pricing of natural gas at the level of replacement cost. Indicated Producers further support the justness and reasonableness of the post-1974 rate

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[132] DOE at 28.

[133] *Id.* at 28-29.

[134] *Id.* at 29-36.

[135] *Id.* at 36-41, n.33.

based on the consideration of various non-cost factors including supply response, commodity value estimates, and the alleged favorable impact the proposed ceiling price would have on all segments of the gas industry including consumers.[136] NGSA supports the proposed ceiling price primarily on the basis of its predicted beneficial effects rather than by reference to specific cost considerations. PGC supports the post-1974 price as being administratively efficient, rationally calculated to reduce market disorders, and properly based on cost and non-cost factors.[137]

Pipeline, distributor and consumer commenters object strongly to the pricing of all old gas at the post-1974 ceiling price. A number of commenters oppose DOE's ceiling price recommendation as being based primarily or exclusively on non-cost factors.[138] AGA, for example argues that DOE's proposal to establish a uniform ceiling price ignores the history of cost differences based on vintages and would improperly rely on market forces to determine the actual price under particular contracts as a result of the good faith negotiation rule.[139] UDC likewise argues that the proposed ceiling price lacks adequate cost support. UDC alleges that the proposed rule fails

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[136] Indicated Producers at 49-53.

[137] PGC at 6.

[138] *See e.g.,* AGA at 15-24; American Public Gas Association (APGA) at 41-44; UDC petition for dismissal (February 10, 1986), Appendix A at 3-11; Peoples Gas Light and Coke Company and North Shore Gas Company (joint comments) at 10-13; Michigan Consolidated Gas Company at 620; Rochester Gas and Electric Corporation at 16-20; Southern California Gas Company at 1-12; Southwest Gas Company at 18; Southern Illinois Gas Company at 1-12; Southern Gas Corporation at 3-5; Columbia Gas Distribution Companies at 2-4; Laclede Gas Company at 6-11; Northern Distributor Group at 6-8; Piedmont Natural Gas Company at 3-7; New York at 3-13; California PUC at 5-12; Arkansas PSC at 4; PSC of Wisconsin at 2-5; PSC of West Virginia at 6-9; PSC of Kentucky at 1-4; PSC of District of Columbia at 2-9.

[139] AGA at 21.

to acknowledge cost as being a necessary foundation for just and reasonable rates and criticizes DOE for failing to consider numerous Commission and judicial precedents holding that costs are a necessary foundation from which a determination of rates must proceed.[140] UDC complains that the proposed rule is based on arguments designed to establish the Commission's authority to base rates on such non-cost factors as "competition, supply, demand, reserves and industry structure." [141] Similarly, Peoples Gas Light and Coke Company and North Shore Gas Company interpret the proposed rule as premised on the assumption that cost may be ignored in establishing just and reasonable rates. They argue that while non-cost factors may be considered, costs must be given primary consideration, and that the Supreme Court has held that in setting rates the Commission lacks authority to place exclusive reliance on market prices.[142] Similar arguments are made by pipelines. INGAA, for example, argues that the proposed rule, "by not even considering the cost data required under the NGA is asking the Commission to exercise powers beyond its authority." [143] Tennessee Gas Pipeline argues that although the courts have approved the use of non-cost factors in conjunction with costs to achieve relevant regulatory purposes, the courts have rejected the idea that just and reasonable rates can be based solely on "non-cost, market factors." [144] Natural Gas Pipeline Company of America argues the proposed rule improperly ignores costs and is instead based on arbitrary rates which "merely allow old gas prices to in-

[140] UDC petition for dismissal (February 10, 1986) Appendix A at 4.

[141] *Id.*

[142] *Peoples Gas Light* at 11-12, *citing FPC v. Texaco,* 417 U.S. 380 (1974).

[143] INGAA at 10.

[144] *Tennessee Gas Pipeline* at 11, *citing FPC v. Texaco,* 417 U.S. 380 (1974).

crease, based solely on market or commodity value factors." [145] Many commenters also argue that the just and reasonable rate for the various old gas vintages must be determined strictly on the basis of historical as opposed to replacement costs.[146] These commenters argue that to the extent the proposed ceiling price exceeds the price which would result from application of prior, Commission-approved historical cost methodologies, it is unjust and unreasonable within the meaning of the NGA and therefore cannot lawfully be adopted.

In its December 20, 1985, notice of procedural schedule, the Commission requested comments concerning alternative methodologies by which just and reasonable rates could be determined in light of contemporary market needs and conditions. In response the United States Department of Justice (DOJ) submitted an alternative old gas price proposal together with supporting comments. DOJ argues that in light of the fact that the natural gas producing industry is competitive, there is no longer any reason or need to continue using costs as a basis for determining just and reasonable rates and recommends that the Commission adopt a rule providing that any price paid for natural gas subject to sections 104, 106(a) and 109 of the NGPA be presumed to be just and reasonable. According to DOJ, the courts have held that the Commission has broad discretion in adopting particular methods of regulation and that it is the "end result" which controls, citing *Hope.* DOJ argues that the proper tests of a just and reasonable rate are (1) does it protect consumers against excessive charges and (2) is it

[145] Natural Gas Pipeline at 25.

[146] UDC reply comments at 26-41; APGA reply comments at 20-41; AGD reply comments at 6-10, Appendix A; AGA reply comments at 7-9; MPC-NASUCA reply comments at 9-10; Southern California Gas Company reply comments at 10; Panhandle Eastern Pipe Line Company and Trunkline Gas Company reply comments at 4-5; Peoples Gas Light and Coke Company and North Shore Gas Company reply comments at 14-17.

consistent with the maintenance of adequate and reliable service.[147] DOJ reasons that since the natural gas market is effectively competitive, market-based rates satisfy the stated criteria.

Commission Response. The just and reasonable rate standard is set forth in sections 4 and 5 of the Natural Gas Act of 1938. In 1954, the Supreme Court held in the seminal decision in *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954), that the Commission has authority under the NGA to regulate the wellhead price of natural gas. Following *Phillips*, the Commission first attempted to regulate rates on a producer-by-producer basis but abandoned this approach as administratively infeasible and moved to determine rates on an area-wide basis. The first area rate case resulted in the landmark *Permian Basin* decision, Opinion No. 468, 34 FPC 159 (1965), which was affirmed by the Supreme Court.[148] In *Permian* the Commission established separate prices for "new" and "flowing" (old) gas. The price for new gas was based on current costs while the price for old gas was based on historical costs. Commencing in 1974, the Commission established producer rates on a national rather than area-wide basis.[149]

In determining just and reasonable producer rates under the NGA, the Commission has consistently relied primarily on costs while also considering relevant non-cost factors. Courts reviewing the Commission's decisions have generally affirmed the Commission's selection of particular cost methodologies and rate structures as being permitted by the reasonable exercise of the Commission's discretion.[150] Notably, the courts have not mandated the

[147] DOJ at 14. *See Shell Oil Co. v. FPC*, 520 F.2d 1061 (5th Cir. 1975).

[148] *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968).

[149] Opinion No. 699-H and Opinion Nos. 770 and 770-A, *supra*.

[150] Opinion No. 699-H, *aff'd Shell Oil Co. v. FPC*, 520 F.2d 1061 (5th Cir. 1975), *cert. denied* 435 U.S. 907 (1978); Opinion No.

use of historical cost methodologies and have affirmed the Commission's use of replacement cost as a proper basis for establishing just and reasonable rates.[151]

There is much controversy reflected in the comments concerning the extent to which the Commission can or should rely on non-cost factors in determining just and reasonable rates. It will be helpful at this point to clarify the issue of reliance on cost versus non-cost factors in evaluating the lawfulness under the NGA of DOE's proposed ceiling price. The rate proposed by DOE has its source in Opinion No. 770, 56 FPC 509, 560-75 (1976). The FPC there established the post-1974 rate at $1.42 per Mcf based on the midpoint of a zone of reasonableness defined by prices derived from two separate estimates of productivity of drilling and the use of two separate DCF cost models. 56 FPC at 567. The price included a four cent per Mcf annual escalation designed to assure a constant rate of return and thereby assure that the price remained representative of the cost of finding and producing natural gas in the future. The price, in other words, represented the replacement cost of gas.[152] The FPC went on at length to consider a number of non-cost factors to ensure that the "end result" was just and reasonable as required by *FPC v. Hope Natural Gas Co. supra.* Non-cost factors considered by the FPC included intrastate market prices, commodity value, and economic impact. 56 FPC at 578-86. However, the FPC did not make any adjustments whatever to the cost-based rate of

749, *aff'd Tenneco Oil Co. v. FERC*, 571 F.2d 834 (5th Cir. 1978), *cert. denied* 439 U.S. 801 (1978); Opinion Nos. 770 and 770-A, *aff'd American Public Gas Association v. FPC*, 567 F.2d 1016 (D.C. Cir. 1977), *cert. denied* 435 U.S. 907 (1978). *See, also Placid Oil Co. v. FPC*, 483 F.2d 880 (5th Cir. 1973), *aff'd, Mobil Oil Corp. v. FPC*, 417 U.S. 283 (1974); In re *Permian*, 390 U.S. 747 (1968).

[151] *Shell Oil Co. v. FPC*, 520 F.2d 1061 (5th Cir. 1975).

[152] 56 FPC at 521.

$1.42 per Mcf based on its consideration of non-cost factors, and used its consideration of such factors solely as a means of verifying or confirming the justness and reasonablenes of the purely replacement cost-based rate.[153] That rate was escalated at the rate of one cent per quarter (four cents per annum) until enactment of the NGPA, and since that time the then-effective rate has been adjusted pursuant to the NGPA's inflation adjustment factor rather than the quarterly adjustment provided for in Opinion No. 770. The rate resulting from this process is the current post-1974 ceiling price of $2.57 per MMBtu as of June 1986.

As a consequence of the adjustment-for-inflation feature of the NGPA it is reasonable to assume the current post-1974 vintage price remains representative of replacement costs, absent a showing that changes in the cost of finding and producing gas have been significantly more or less than average inflation in the economy as a whole. The record demonstrates that the post-1974 price remains reasonably representative of current replacement costs. Indicated Producers provide a study estimating the 1985 replacement cost of gas based on a recalculation of the Opinion No. 770 discounted cash flow (DCF) cost model using current costs and updated values for such items as rate of return, federal income taxes, investment tax credits, and working capital.[154] The result of this calculation is a current replacement cost of $2.77 per MMBtu. Since the ceiling price is a purely replacement cost-based rate and does not include any allowance for non-cost factors, it is unnecessary in evaluating the reasonableness of the proposed ceiling price to consider the extent to which the Commission could or should base the ceiling price for old gas on non-cost factors. The question presented is straightforward and simple, namely, is the proposed uniform ceiling price for old gas, based on re-

[153] 56 FPC at 515; *APGA v. FPC, supra*, 567 F.2d at 1030.

[154] Indicated Producers, Appendix A.

placement cost, just and reasonable within the meaning of the NGA? For the reasons hereinafter discussed, we conclude that it is.

The just and reasonable rate standard has never been interpreted to require that rates be based on historical or original cost. As early as 1945, Justice Jackson, concurring in *Colorado Interstate Gas Co. v. FPC*, 324 U.S. 581 (1945), a case involving the justness and reasonableness of pipeline rates established under the NGA, stated that "farsighted gas rate regulation will concern itself with the present and future, rather than with the past, as the rate base formula does." 324 U.S. at 612. More recently, in affirming the Commission's establishment in Opinion No. 749 of a uniform price for flowing gas, the Fifth Circuit stated that "the choice between actual cost and replacement cost is for the Commission to make, subject to the sole requirement that the end result be within the 'zone of reasonableness.'" *Tenneco Oil Co. v. FERC*, *supra*, 571 F.2d at 840.[155] The Supreme Court has recognized that gas producers are not typical public utilities. Justice Harlan, speaking for the Supreme Court in *Permian*, stated that "Producers of natural gas cannot usefully be classified as public utilities. They enjoy no franchises or guaranteed areas of service. They are intensely competitive vendors of a wasting commodity they have acquired only by costly and often unrewarded

[155] The old gas ceiling price established in Opinion No. 749 was 29.5 cents per Mcf. The Tenneco court commented on the disparity between this rate and the then-effective new gas price of $1.42 per Mcf as follows: "Complicating the Commission's attempts to resolve this difficult balance [between producers and consumers] is the *gargantuan inequity* that results when some consumers, merely because they contracted first, get natural gas at a price which is less than one-fifth of the price that other consumers pay for natural gas or any other comparable energy source." 571 F.2d at 839 (emphasis added).

search. Their unit costs may rise or decline with the vagaries of fortune." [156]

It is beyond doubt that producers must, on average, and over the long run, receive revenues for sales of gas which are sufficient to encourage and enable them to explore for and develop new reserves needed to replace those being consumed. Only in this way can there be any reasonable assurance that natural gas will be available in quantities sufficient to provide adequate and reliable service to current as well as future generations of consumers. Under the existing old gas price structure, many categories of old gas are frozen at prices well below replacement costs as well as below current market prices, which are themselves well below replacement costs. Where prices for a substantial portion of natural gas are regulated at prices substantially below (and in some cases only a fraction of) current market prices, and where the remainder of the market is unregulated, it is inevitable that the price of the unregulated supply will, over time, increase disproportionately relative to the market price, such that the average price realized by producers is at least equal to the market price. The result is an extreme difference between regulated and unregulated prices. This fact accounts for the wide disparity which occurred in the price structure of natural gas both as between interstate and intrastate prices and among vintages of old gas prior to enactment of the NGPA, and as between old gas and new gas under the NGPA. The pricing of old gas at below-market prices has led, in principal part, to prices being realized by producers for new and deregulated gas under the NGPA which are far in excess of market prices and which are a prime cause of dysfunction in today's natural gas market.

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[156] *Permian*, 390 U.S. at 756-57 (footnote omitted). *See also Southern Louisiana Area Rate Cases*, 428 F.2d 407 at 634 (5th Cir. 1970).

The Commission has previously determined that natural gas ceiling prices should be established at a uniform level based on replacement costs. In the first national rate proceeding, Opinion No. 699-H, the Commission established a rate for new gas based on current replacement costs and provided that producers selling gas under expiring contracts would be entitled to the new gas ceiling price upon negotiation of renewal contracts with their purchasers. Opinion No. 699-H, 52 FPC at 1631-32. The effect of this decision would have been to eliminate vintaging gradually as old contracts expired and were renegotiated with the result that all categories of gas would ultimately be priced at the new gas ceiling price based on replacement costs or at current market prices, whichever is lower. Furthermore, the Commission held that all gas which initially qualified for the new gas ceiling price would be entitled to the ceiling prices determined in succeeding national rate proceedings. 52 FPC at 1636. In explaining its actions in Opinion No. 699-H, the Commission stated as follows (52 FPC at 1637):

> The adjustment of all rates for post-December 31, 1972, dedications to the newly established rate will also over an extended period of time result in a uniform base price for gas sold in interstate commerce, which equates to the cost of replacing the unit of gas consumed. This uniform price will constitute a recognition of the fact that gas is a consumable irreplacable commodity and not a service which can be renewed by man. (footnote omitted).

Opinion No. 699-H was upheld on judicial review in *Shell Oil Co. v. FPC*, *supra*. In affirming the Commission, the court in *Shell* stated as follows (520 F.2d at 1076-77):

> The practical result of allowing flowing or "old" gas to be sold at the new national rate upon expiration or renegotiation of preexisting contracts is that the former "vintaging" of gas according to its period

of discovery will gradually disappear. The Commission is not bound by its previous policies. As this Court and the Supreme Court have noted on various occasions, the rate structures which introduced or adjusted vintaging were experimental. It is necessary without a doubt that agencies be permitted latitude to evaluate old experiments and modify or abandon them when their best judgment requires such a course of action. The Commission's reasons for permitting old gas to be repriced at the new rate apply equally to the related decision to abandon vintaging.

In the second national rate proceeding, Opinion Nos. 770 and 770-A, the Commission reversed its decision in Opinion No. 699-H, and reestablished vintaging. Opinion No. 770, 56 FPC at 521. The Commission held that while it was "aware of the problems occasioned by the continuance of the vintaging concept," it was necessary to reimpose vintaging in light of the magnitude of the increase in the previous national rate (from 50 cents to $1.42 per Mcf) and the need to "preclude the exaction of excessive and unjustifiable economic rent from flowing gas." 56 FPC at 521 (footnote omitted). Opinion Nos. 770 and 770-A were likewise affirmed on appeal, *American Public Gas Association v. FPC*, *supra*, in which the court held that "the Commission has latitude to reconsider its experiment in abandoning vintaging." 567 F.2d at 1033.

It seems clear based on the above-cited judicial precedents that the issues of replacement costs versus historical costs as well as vintage-based versus uniform rates are matters within the Commission's reasonably exercised discretion. Based on the record in this case, the Commission concludes that to continue the decision in Opinion Nos. 770 and 770-A to reinstate vintaging is no longer wise or consistent with sound regulatory policy. The record in this proceeding demonstrates that the pricing

of regulated gas below the marginal cost of gas produces distortions in the exploration and development of additional gas supplies and in the consumption of all gas supplies.[157]

The NGPA provides strong economic support for pricing old gas at the long-run marginal cost of gas, which is equivalent to replacement cost. As we have previously noted, Congress in enacting the NGPA implicitly recognized that the natural gas producing industry is workably competitive.[158] This fact has been recognized by the Commission [159] as well as the courts [160] and the validity of the competition premise has been amply demonstrated by experience subsequent to the NGPA's enactment.[161] We agree with the persuasive analysis of the Department of Justice concerning the determination of prices in a competitive market. DOJ summarizes that process as follows (DOJ at 7-8):

> In a competitive industry, market forces drive prices toward the producer's marginal cost. Where price equals marginal cost, consumers are paying precisely the social cost incurred to produce the last unit of output. If at any time the price is too high, excessive returns will encourage other producers to enter the market, thereby increasing production, lowering prices, and eliminating excessive returns. Similarly, if demand increases, price will rise, encouraging additional production that was not economically viable at the lower price. This process will continue until supply and demand reach equilib-

[157] *See* discussion in Sections IV. B and IV. D.

[158] *See* discussion, *infra* at 140-41.

[159] Order No. 436, 50 FR at 42418.

[160] *Pennzoil v. FERC*, 645 F.2d 360 (5th Cir. 1981); *Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Board of Mississippi*, 474 U.S. ——, 88 L.Ed. 2d 732 (Jan. 22, 1986).

[161] *See* discussion, *infra* at 140-44.

rium and price reflects marginal cost. Prices established by competitive market forces are in this way driven toward marginal cost. Such prices send the proper signals to both producers and consumers, leading them to produce and consume the optimal amount of goods and services, and thus ensuring that society makes the most efficient use of its resources. (Footnotes omitted).

Thus, in a competitive market, prices are driven toward marginal or replacement cost. In the terminology of economics this is referred to as unconstrained marginal cost pricing.[162] Since the natural gas market is in fact competitive. DOJ argues that market prices are just and reasonable *per se*, absent fraud, abuse or similar conduct. We agree that marginal costs best reflect the level at which prices would be established if deregulation of old gas were to occur. Since the purpose of regulation is to attempt to achieve the price, profit, output and efficiency levels that would exist were the regulated market actually competitive,[163] it follows that the regulated price should reflect marginal cost to the extent allowed by law. It should be noted that the post-1974 rate constitutes only a ceiling price. Under DOE's good faith negotiation rule, old gas would actually be priced at the prevailing market price or the new ceiling price, so the practical effect of the proposed rule is to provide a price for old gas equal to the market price or replacement cost, *whichever is lower*. Thus, to the extent the new ceiling price is not constraining, DOJ's analysis and conclusions apply. However, the new ceiling price serves as

[162] In *Tenneco v. FERC, supra*, the court recognized that "in a free market, competitive bidding would tend to equalize the prices of flowing and new gas. The Commission's vintaging policy insulates consumers from market forces and provides them with gas at one-fifth the price of replacement gas." 571 F.2d at 841.

[163] *Northern Natural Gas Co. v. FPC*, 399 F.2d 953 (D.C. Cir. 1968).

a regulatory guarantee that old gas prices will not exceed replacement cost even if marginal cost pricing would require such a result.

The fact that there is an excess of gas deliverability at the present time in no way affects the determination of the just and reasonable rate. As prices fall due to the current surplus, exploration and supply will decline[164] and demand and consumption will increase. At such time as supply and demand reach equilibrium, as they surely will, the price of deregulated gas will rise disproportionately above the market determined price unless the old gas price structure is modified, and the cycle of boom and bust will be repeated. Allowing old gas to be priced up to the level of replacement cost will help break the cycle. Obviously there can be no guarantee that the post-1974 price will remain market responsive due, among other things, to possible changes in the supply of and demand for gas, which ultimately determines the market price of gas. Thus there can be no assurance that there will not occur in the future a divergence in price as between new and old gas. However, we believe that the action taken in this rule represents a pragmatic approach the Commission can take within its authority under the NGA and NGPA to eliminate distortions in the price structure of natural gas and to make that structure more economically efficient. The effect of this rule will be to reduce significantly price distortions which would occur in the event no changes were made in the existing price structure.

Once the Commission has determined to base the new ceiling price for old gas on replacement cost, it must define the current replacement cost of gas. Then the Commission must determine how to incorporate replacement cost into the new ceiling price. The Commission must also decide whether to further adjust the new ceiling

[164] *See* IPAA at 3-4.

price by including additional factors in its definition besides replacement cost. Finally, the Commission must determine whether the new ceiling price, based on replacement cost and other relevant factors, is just and reasonable within the meaning of the Natural Gas Act.

In defining the current replacement cost of gas, the Commission has considered the comments in the record, its own precedents, and data on the technology of exploring for and developing natural gas reserves.

First, the Commission has considered its most recent definition of replacement cost, incorporated into the rate for new gas for the 1975-1976 biennium under Opinion No. 770-A and adjusted for inflation by Congress under the NGPA. Because this definition of replacement cost was affirmed on judicial review and incorporated by Congress into the NGPA, the Commission considers it an approved point of departure for determining the replacement cost of gas in 1986.

In Opinion Nos. 770 and 770-A, the Commission established a "zone of reasonableness" for the replacement cost of gas in the 1976 test year of between $1.31 per Mcf and $1.54 per Mcf, each escalating at 4 cents annually.[165] Based on this estimate of replacement cost, the Commission then set $1.42 per Mcf, also escalated 4 cents annually, as the new rate for post-1974 gas. NGPA section 101 then provided for escalation of the post-74 rate according to an implicit GNP deflator. Thus, the Opinion 770-A "zone of reasonableness" for the current replacement cost of gas, adjusted by the NGPA price deflator, would be between $2.37 per MMBtu and $2.79 per MMBtu in June 1986.

To determine whether the Opinion 770-A replacement cost is still reasonable, the Commission has reviewed the "discounted cash flow" ("DCF") methodology on which

[165] 56 FPC 567.

it was based. The DCF methodology, first used by the Commission in Opinion 699-H, recognizes that the value of an investment extends over time and that the present value of the cash flow from that investment must yield a rate of return comparable to other investments with similar risk. By examining the cash flow of the investment over the life of the project, the DCF analysis is able to account for cost of capital for invested funds, including dry hole expenditures, and variations in cash flow. By viewing the project in its entirety, the DCF analysis permits determination of a rate of return that compensates investors for their risks and encourages future drilling efforts.

Specifically, the DCF methodology used in Opinions No. 699-H and 770-A assumes a single project and focuses an anticipated cash flow over the life of a well rather than on revenues and costs in any one year as does a rate base cost of service method. The principal costs or negative cash flows are assumed to occur in the 3-year preproduction period. Operating expenses and other expenditures, as well as projected revenues, are assumed to occur during a 15-year productive period.

In addition to DCF analysis, Opinion Nos. 699-H and 770-A also applied modifications to the replacement cost methodology which originated in *Permian I*.[166] Basically, *Permian I* estimated the average unit cost per Mcf of gas produced from successful gas wells during a selected test period. The unit cost is derived by dividing the cost per foot of drilling and equipping the average successful gas well by its estimated productivity. Estimated productivity was derived by dividing the additions to nonassociated gas reserves by related gas well footage. However, the costs of unsuccessful wells were treated as expenses, and were not included in the investment rate base. *Permian I* then provided an average investment recovered over the depletion life of the average gas well.

[166] 34 FPC 159, *aff'd* 390 U.S. 747 (1968).

Besides modifying *Permian I* to adopt DCF analysis, Opinion 699-H included dry-hole expenditures in the rate base and considered the effects of Federal income taxes in its cost analysis. This is because exploratory drilling is the principal source of new gas supplies, and a successful exploratory drilling routinely will result in the drilling of many dry-holes. Thus, a key variable in the Opinion Nos. 699-H and 770-A cost methodology becomes "productivity," in terms of the amount of natural gas added to reserves for every foot of drilling that results in some addition to reserves. The productivity factor determines successful well cost per Mcf, which in turn underlies other cost inputs, such as dry-hole cost per Mcf, lease acquisition cost per Mcf, and other production and exploratory costs per Mcf.

In establishing the $1.42 per Mcf post-74 new gas rate, Opinion 770-A itself modified the Opinion No. 699-H cost inputs in certain respects. Drilling costs were changed to reflect higher costs actually incurred in 1973 and 1974. Productivity data were expanded from 7 years (1966-1972) to also include 1973 and 1974 data. The depletion life of the average well was changed from 18 years to 15 years (with a 3-year pre-production period). In view of the repeal of the percentage depletion allowance in the Tax Reduction Act of 1975, income tax liabilities were estimated based on a marginal tax rate of 48 percent. A 15 percent rate of return was allowed.

On judicial review, the D.C. Circuit affirmed the Opinion No. 770-A rate of $1.42 per Mcf against challenges to the DCF methodology and the inputs chosen by the Commission for drilling productivity and income taxes payable. In response to the charges that the Commission relied on unverified industry-collected data for successful feet of drilling and for gas reserves added, the court held that such reliance was not unreasonable, especially where the Commission attempted to correct for any weakness in the data by using an 8-9 year multi-year average.

Using the two multi-year averages (8 years and 9 years), the Commission had calculated average productivity as 300 Mcf/ft, the midpoint of a range between 279 Mcf/ft (9 years) and 323 Mcf/ft (8 years). In response to the contention that the Commission had estimated tax liability based on an economic model rather than on actual taxes paid, the court sustained the economic model. The model had assumed taxes payable at a 48 percent corporate rate, and estimated that 27 cents of the total 43 cents allowed for taxes was attributable to the repeal of the percentage depletion allowance effective July 1, 1976.

Based on this review, the Commission concludes that the Opinion No. 770-A DCF methodology, as sustained on judicial review, is still a reasonable methodology for calculating the replacement cost of gas. DCF analysis calculates replacement cost on the basis of the more reliable time value of money, and thus produces an estimate of the true yield over the life of an investment. In addition, the key input of productivity is calculated by using trended drilling costs and reserve additions over a multi-year range representative of the long-term nature of reserve replacement. The capitalization of dry-hole costs also recognizes the inherent long-term risks of exploratory drilling, itself the key variable in replacing gas reserves. Finally, Opinion No. 770-A includes an estimate for income taxes payable, in order to quantify the key role tax liability plays in drilling investments.

The Commission notes that Congress intended the replacement cost rate for post-'74 gas to be updated by reference to the implicit price deflator included in NGPA section 101. This is because section 101, when read in conjunction with sections 104(b)(2) and 106(c), preempts any attempts by the Commission to revise the NGPA ceiling price for post-74 gas *downward*, based on any Opinion No. 770-A DCF analysis that yields a current replacement cost of gas less than that yielded by the NGPA price deflator.

The second estimate of replacement cost the Commission has considered is the $2.77 per MMBtu estimate included in the initial comments of the Indicated Producers. The Indicated Producers updated the Opinion No. 770-A DCF analysis to include the most recently available data on productivity, reserve additions, income tax liability, drilling costs, and the industry capital structure.

A price adjustment of 4 percent annually over 15 years beginning in 1986 was used for the NGPA price deflator. Productivity was estimated at 145 Mcf/ft, based on a 5-year range of 120 to 159 Mcf/ft between 1980 and 1984. Income taxes were estimated on the basis of the current 46 percent corporate income tax rate and the 8 percent rate for investment tax credits.

Successful gas well and dry-hole costs per foot were calculated on the basis of an average of 1984 and 1985 costs calculated by the American Petroleum Institute and the Energy Information Administration. Lease acquisition costs were estimated as decreasing at the same rate as producing well costs, 15 percent annually since 1982, the most recent year for which actual least costs are available. Other exploratory costs were estimated on the basis of an assumption that they have decreased at the same rate as successful gas well costs since 1982, the last year actual data is available. In any case, the ratio of other exploratory costs to successful gas well costs is calculated to be the same as the 1979-1982 average, which itself is less than one-third the 1970-1974 average used in Opinion No. 770-A. Similarly, exploratory overhead costs are assumed to have decreased at the same rate as dry-hole costs since the last available data in 1982. Dry-hole footage and deeper dry-hole costs are based on 1981-1984 ranges.

Inputs not changed from the Opinion No. 770-A data include operating expenses, regulatory expenses, cost allocations to gas, royalty costs, other production facilities

costs, and recompletion and deeper drilling costs. Finally, based on the increased debt/equity ratios in the industry capital structure, a 13.25 percent computational rate of return was used, compared to 14.16 percent under Opinion No. 770-A.

The Commission considers productivity to be the factor most likely to affect the accuracy of the Indicated Producers' estimate. Productivity is the ratio of reserve additions to successful drilling footage, and the Indicated Producers use a 5-year range, as opposed to longer 8 and 9 years ranges used by the Commission in Opinion No. 770-A. In order to assure that the 1980-1984 productivity range of 120 to 159 Mcf/ft is not inconsistent with a more reliable range, the Commission has recalculated the productivity factor based on data for the most recent 8 years available, 1977-1984. This requires adding data for the years 1977-1979 to the 1980-1984 data used by the Indicated Producers. The following table summarizes the data:

Year	*Reserve Additions (Bcf)*	*Drilling Footage (000's)*	*Productivity (Mcf/foot)*
1977	13,098	59,538	220
1978	16,122	70.196	230
1979	13,326	77,756	171
1980	12,102	85,032	142
1981	15,351	96,846	159
1982	12,819	107,159	120
1983	10,131	83,202	122
1984	12,099	82,107	147
Used by Indicated Producers			145

This data indicates the 145 Mcf/ft estimate is within the range of productivity factors experienced since 1977. In addition, the other cost factors used by the Indicated Producers, such as dry-hole costs and successful well costs, are within the range of cost increases indicated by the general rate of inflation in the overall economy since Opinion No. 770-A. Finally, where certain cost factors, such as production facilities cost, other exploratory costs,

and lease acquisition costs, are extrapolated from less recent actual data by comparison to the general downward trend of drilling costs, the calculation appears reasonable.

For these reasons, the Commission concludes the Indicated Producers' \$2.77/MMBtu replacement cost estimate is reasonable because it updates the Opinion 770-A DCF inputs to reflect changed industry conditions since 1976.

In reviewing these two estimates for replacement cost, the Commission has considered technological factors which affect the economics of reserve replacement.

As the office of Technology Assessment (OTA) has explained, the discovery of new gas fields represents the single most important force necessary for building a sustainable natural gas supply.[167] A new gas field not only adds to current reserves, it also provides a source of considerably larger additions to future reserves through field growth after the discovery year. Therefore, the economics of new field discovery rates are an important factor in defining the long-term replacement cost of gas.

According to OTA, the rate of annual additions to reserves from new field discoveries depends on several key variables:

—*The undiscovered resource base.* The geologic nature of the remaining resource base, such as amount; location, size, and distribution of fields; and types of geologic traps; all influence the future discovery of new fields. In this respect, the Commission notes that the *average size* of new gas fields has become considerably smaller over the last twenty years. Thus, the rate of new field discoveries is much more dependent today on sustaining a strong and stable

[167] *U.S. Natural Gas Availability: Gas Supply Through the Year 2000*, Office of Technology Assessment, OTA-E-245 (February 1985) at pp. 82-86.

level of drilling over time, than on the erratic discovery of a small number of giant fields.[168] For this reason, the Commission considers that the decline in gas well completions since 1981, accelerated by this year's collapse in drilling, will, if continued for several years, cause a serious shortfall in reserve additions beginning when the current surplus deliverability disappears. The Commission concludes that setting old gas prices at replacement cost would not only help stem any overall shortfall in gas drilling, it would also assure the availability of enhanced old gas supplies to plug the gap in reserve replacement when today's drilling slump causes a decline in new field discoveries by the early 1980s.[169]

—*Exploration, drilling, and production technology.* Overall discovery rates are affected by drilling success rates and development costs. These costs themselves are dependent on improvements in technology, hydraulic fracturing for tight sands, and offshore drilling techniques for deep water drilling. In this regard, the Commission notes that, although drilling costs may have declined since their late-1970s peak, the basic trend of new field discoveries—from high-permeability to low-permeability sands, from shallow to deeper zones, and from conventional techniques to more costly, complex, capital-intensive techniques—has not changed. For example, although most new field discoveries continue to come from more traditional gas producing areas, such as onshore and in the Gulf of Mexico, these areas are considered mature and future discoveries are expected to come by more expensive means, such as drilling in deeper waters of the Gulf or in tighter sands on-shore. For this reason, although the success rate of the domestic drilling industry can remain high, the Commission

[168] *Id.* at 85.

[169] *Id.* at 83.

concludes that the real costs of this success rate are likely to increase over the long-term, as the technology necessary to sustain the success rate keeps pace with the more complex and difficult geology of the new areas explored.

—*Historic and current gas prices, and industry willingness to take risks.* With new gas field discoveries coming from smaller fields and under more risky technologies and geology, gas prices and return on investment become much more important. Higher gas prices for current gas production increase cashflow and internally generated capital in the drilling industry overall. But, as demonstrated by the commenters in this record, they also allow delayed abandonment or enhanced recovery of wells whose production would otherwise be uneconomic at current prices.[170] Higher prices are also a primary factor in encouraging exploration and development of those new field prospects that are already known through previous exploratory activities, but have not been developed because of economic conditions or the availability of more promising prospects elsewhere. According to OTA, the past exploratory experience of existing producers is therefore a principal determinant of positive charges in new field discovery rates over the short-term.[171]

Based on the technology and geology of new gas field discovery rates, the replacement cost of gas should be that price necessary to compensate for likely long-run increases in real drilling and development costs in frontier areas. The price should also assure that exploration and development capital is more efficiently allocated to enhancing recovery in existing fields or to drilling new prospects which are already known from past exploratory experience.

[170] *See e.g.* initial comments of Indicated Producers, DOE, AGA.

[171] *U.S. Natural Gas Availability*, op. cit. at 83.

The Commission considers that the current pre-1985 weighted average cost of new gas under sections 102 and 103 of the NGPA represents a reasonable non-cost factor on which to compare the two replacement cost prices established under DCF analysis. This is because the most recent period in which drilling levels sustained the highest level of reserve replacement was 1979-1984, the years when pipelines purchased the bulk of their new supplies of offshore and onshore gas. Because of the continuing distortions of the old gas cushion, these years also represent a balancing between the price distortions caused by perceived shortages at the beginning of the period and a perceived surplus at the end of the period. The years 1985 and early 1986 themselves represent one extreme of the these distortions. However, the *current* 1986 average cost of sections 102 and 103 gas ($3.14 per Mcf as of April 1, 1986) is used in order to assure an estimate at the conservative end of actual replacement cost.

Based on these two DCF estimates of replacement cost and the non-cost factor of current average new gas prices, the Commission concludes that the long-term replacement cost of gas is within a range whose low point is the estimate of replacement cost in Opinion Nos. 770 and 770-A, adjusted by the NGPA deflator ($2.57 per MMBtu as of June, 1986). The Commission concludes the high point of the range of current replacement cost is the Indicated Producers' updated DCF replacement cost estimate ($2.77 per MMBtu). The midpoint of this zone of reasonableness for replacement cost is $2.67 per MMBtu.[172] However, because of the volatility of the Indicated Producers' estimate of the productivity factor, the Commission will incorporate the low point of the replacement cost range, $2.57 per MMBtu, into the definition of the new ceiling

[172] The Commission notes that even the $2.77/MMBtu replacement cost estimate by the Indicated Producers is below the $3.14 per Mcf current average cost of new gas under NGPA sections 102 and 103.

price; $2.57 per MMBtu is the most recent estimate of replacement cost based on a full national rate case and is expressly updated by Congress to reflect the general effects of inflation. Although $2.57 per MMBtu may not as accurately reflect the changes in DCF inputs since 1976 as the Indicated Producers' $2.77 estimate does, the Commission nevertheless considers the lower estimate more reasonable, because it recognizes that any prediction of replacement cost is subject to constant changes in its input variables, such as productivity, income taxes payable, and drilling costs. Therefore, defining the new ceiling price for old gas based on the $2.57 per MMBtu low estimate will protect consumers against potential inaccuracies in the Indicated Producers' updated estimate. At the same time, $2.57 per MMBtu is within the minimum estimate of replacement cost necessary to compensate producers for the time value of money invested in finding and developing new supplies of gas for future consumers. For these reasons, the Commission determines that $2.57 per MMBtu is a just and reasonable ceiling price within the meaning of the Natural Gas Act.

However, the Commission also recognizes that current average wellhead prices, especially those in spot markets, are likely to be *below* the $2.57 per MMBtu new ceiling price when it takes effect. Because reserve replacement is tied closely to drilling, and drilling levels have declined substantially over the last 2 years, the Commission considers that current wellhead prices are themselves below the long-term cost of replacing gas reserves at the margin, even though they may accurately reflect the short-term marginal costs of buying gas in the market place.

In order to assure that old gas prices are paid at the current market price or the ceiling price, *whichever is lower*, the Commission has incorporated the "good faith negotiation" procedures into the ceiling price as a further restriction on its collection under existing contracts.

The "good faith negotiation" procedure prohibits a first seller from collecting the new ceiling price from an existing purchaser under an indefinite price escalator clause, unless the parties have mutually agreed to the new price under current market conditions. The "good faith negotiation" procedure thus is an integral part of the definition of the new ceiling price itself.

The $2.57 per MMBtu price established by this rule will operate only as a ceiling price, and actual prices paid for old gas in the market place are likely to be substantially *below* the ceiling price as long as the current surplus deliverability keeps short-term marginal costs below the actual replacement cost of gas. Of course, as the market clears the surplus and supply and demand come into balance, the market prices for old gas will more closely reflect its long-term replacement cost. When this happens, the $2.57 MMBtu price will restrict market forces from raising old gas prices above the just and reasonable ceiling price set by this final rule.

Based on the foregoing considerations as well as our findings concerning the unjustness and unreasonableness of the existing old gas price structure and the effect of the proposed rule on gas supply and overall prices, the Commission finds that the proposed ceiling price is just and reasonable within the meaning of the NGA.

D. Effect of Higher Prices on Old Gas Production.

The Commission finds that eliminating vintaging will substantially increase recoverable reserves of old gas through delayed abandonment of wells. Since a well's pressure and production decline over time, revenues from the well also decline. When those revenues no longer offset the costs of production (which remain relatively constant), a producer will abandon the well. Therefore, raising the ceiling prices for pre-1974 gas will permit production to continue to a lower pressure and level of

production, since revenues will not outstrip costs until production has fallen to a lower level.

Comments. DOE, large and small producers, public service commissions in producing states, and trade associations representing industrial and other large end-users generally agree that the proposed rule will result in increased production of old gas, since wells will remain economic to lower pressure levels. DOE estimates that the increase will be between 9 and 12 Tcf. Its best estimate is 11 Tcf.

DOE's estimate is based on a methodology first developed in a study by C. S. Matthews of the Shell Oil Company in April 1983 (the 1983 Shell study). That study sought to estimate the increased production resulting from total decontrol of natural gas prices. Dr. Matthews picked the fourteen largest gas fields in the U.S., accounting for approximately thirty percent of total nationwide production of old gas, as representative of all gas in the nation. For each field, the increase in recoverable reserves from lower abandonment pressure was estimated. The fourteen field data were then extrapolated to a nationwide basis [173] to estimate the total increase in production.[174] While DOE uses the same general methodology as Shell, it makes certain modifications both in the methodology and data employed. It makes these modifications in response to various criticisms of the Shell study made by Congress' Office of Technology Assessment

[173] The extrapolation was made as follows: First, total January 1, 1981 national reserves of old gas responsive to deregulation were calculated to be 115 Tcf. This figure was divided by the January 1, 1981 recoverable reserves in the fourteen fields of 41.3 Tcf to obtain a scaling factor of 2.8.

[174] The Shell study estimated that decontrol would permit production of an additional 27 Tcf through delayed abandonment. It also found that decontrol would bring about production of an additional 18 Tcf through infill drilling and 7 Tcf through additional production enhancement work, for a total of 52 Tcf.

(OTA)[175] and to reflect increased production from DOE's old gas proposal as opposed to total decontrol. For example, DOE assumes a price increase only to the new ceiling price. Also, it scales down the final result in order to correct for the fact that some of the increased production predicted by the Shell methodology would occur in any event under existing NGPA incentive prices.

Indicated Producers present an update of the Shell study to show the effect of the DOE proposal. The updated study assumes an increase in price to the new ceiling price but otherwise uses essentially the same data and methodology as the original study.[176] This study predicts that the old gas proposal will increase old gas production by 16 Tcf through delayed abandonment over the life of the old gas fields. Individual producers present data showing that their wells would remain economic for a longer period if vintaging is eliminated.[177]

Pipelines, distributors, their trade associations and consumer representatives generally either deny that elimination of vintaging will increase recoverable reserves or state that DOE and producers have greatly overestimated the increase. These commenters state that the DOE and

[175] These criticisms were made in a memorandum by the OTA staff entitled *Effects of Decontrol on Old Gas Recovery* dated February 1984. Congress's Technology Assessment Board neither reviewed nor approved the memorandum. The memorandum, while criticizing the Shell study, found that decontrol would permit production of an additional 7-20 Tcf through delayed abandonment, 7-14 Tcf through infill drilling, and 4 Tcf through well stimulation, for a total of 19-38 Tcf. OTA assumed that under decontrol prices would rise to $3.50 to $4.00 per MMBtu.

[176] The only change from the previous methodology was to use a somewhat smaller ratio in scaling the fourteen field result to the national level. This was done in order to account for the fact that certain intrastate gas which would have been allowed a higher price under total decontrol will not be allowed a higher price under the DOE proposal.

[177] *See* Hewit and Dougherty 17-20 and DuPont at 23-25.

Shell studies are flawed. For example, they claim that the fourteen fields chosen by Shell are not representative of the nation's gas fields generally, that much of the data used to estimate the increased production in the fourteen fields is unreliable or outdated, and that the studies improperly include in the predicted increase in production some gas which would be produced in any event under existing NGPA incentive prices such as those for stripper wells and production enhancement activities. AGA presents the most detailed critique of the DOE and Shell studies. A number of other commenters, including the Associated Gas Distributors, Northern Distributor Group, and the Northern Indiana Public Service Company, adopt AGA's comments.

Commission Response. The Commission believes that raising the MLP for all old gas to that permitted for post-1974 gas will substantially increase recoverable reserves of old gas since the additional revenue on pre-1975 wells to produce to lower pressure levels. The evidence presented by individual producers that elimination of vintaging would permit their wells to operate longer before costs out-strip revenues confirms this conclusion. For example, Hewit and Dougherty state that under the present 61¢ small producer ceiling price for flowing gas, their wells in the Normanna Field in Texas can produce only fifty percent of remaining reserves before costs outstrip revenues. An increase in price to $2.00, however, would permit their wells to produce 85 percent of those reserves, and an increase to the new ceiling price of $2.54 would permit production of 88 percent of reserves. They also observe that since the wells will in any event "water out" before production declines to the level necessary to qualify as a stripper well, none of this increased production could occur under NGPA section 108 incentive prices.[178]

[178] *See also* DuPont at 23-25.

Even the AGA, which has provided the most detailed critique of the Shell and DOE old gas supply response studies, concedes that there will be some increase; however it claims that the increase will be only about a third of that claimed by DOE.[179] While eliminating vintaging will increase recoverable reserves, the Commission recognizes the difficulty in predicting the precise amount of the increase in recoverable reserves. However, for the reasons stated below, the Commission believes that the increase will be substantial and that the DOE prediction of an approximate 11 Tcf increase is the most convincing analysis in the record of what that increase will be.

Some commenters argue that the fourteen fields relied upon in the DOE and Shell studies are unrepresentative of gas fields generally since they are larger than average. This allegedly results in overestimation of any increase in production since larger fields generally have larger increases in reserves over time. The commenters refer to the OTA's study in support of this contention. However, while OTA stated that most of the experts it consulted believed that the fourteen fields might have a larger supply response than the remaining fields, the reverse may be just as likely. OTA explained that economies of scale may have already permitted greater recovery of large fields' reserves than small fields' at current regulated prices.[180] Accordingly, small fields might have a greater remaining potential supply response than large fields, and use of the fourteen fields may lead to an underestimate of the overall supply response. In any event, while the size of the fourteen fields may mean that the predicted increase in reserves for those fields is not totally representative of that for the nation as a whole, no commenter presents any evidence to suggest that this problem so significantly distorts the results of the DOE

[179] *See* AGA reply comments at Appendix A, page 1.

[180] *See* OTA study at 43-45.

study as to undermine the conclusion that elimination of vintaging will bring about a substantial increase in recoveragle reserves.[181] In addition, the Commission observes that while the fourteen fields are larger than average, they do represent a wide range of characteristics, including discovery years from 1918 to 1963, depths ranging from 1450 to 20,000 feet, and both carbonate and sandstone reservoirs.

The opposing commenters' criticisms of the reliability of the data used in calculating the increased production from the fourteen fields do not undermine the conclusion that elimination of vintaging will cause a substantial increase in recoverable reserves in those fields. These commenters' specific criticisms are as follows. First, they state that the data for the pressure at which wells in the fields would be abandoned under existing prices is based on subjective engineering judgments which do not take into account the facts that pipelines might absorb certain costs such as the cost of compression and that producers might continue operating wells even after revenues go below production costs to avoid the costs of plugging the well. An overestimate of current abandonment pressures would lead to an overestimate of the supply response. They allege that some of the fourteen fields would not produce below their current abandonment pressure because water would intrude into the field below

[181] A recent EIA analysis of DOE's proposed rule supports the conclusion that the size of the fourteen fields does not cause DOE's study to underestimate the overall supply response. EIA did an independent study to determine the supply response from DOE's proposal. EIA based its study on production data from 557 fields in Texas rather than the 14 fields relied on by DOE. The 557 fields included many small fields as well as large fields. EIA nevertheless estimated the DOE proposal would result in increased production through delayed abandonment of 11.7 Tcf compared to DOE's 11 Tcf estimate. An Analysis of the Department of Energy's Notice of Proposed Rulemaking (NOPR), "Ceiling Prices: Old Gas Pricing Structure," EIA (May 1986) at 19-25. *See* further discussion of EIA analysis, *infra* at p. 164.

that pressure. They also complain that the data for current reserves and current pressure are for January 1981, are thus outdated and that a more accurate result would be obtained by using current data. They also complain that the figures for current field pressure are not the actual current field pressures, but represent estimates based on data for initial field pressure,[182] ultimate reserves, production to date, remaining reserves, and existing abandonment pressure.[183] Finally, the commenters contend that the Shell and DOE studies unrealistically assume that if vintaging is eliminated, prices of old gas will rise to the new ceiling price ($2.57 as of June 1986) even though current market prices allegedly are only $1.90 to $2.00 Mcf.[184] The lower the prices resulting from eliminating vintaging, the less the additional production that can be expected. AGA has presented a table substituting data for the fourteen fields which it alleges is more reliable than that used by Shell and DOE, including a price rise to $1.90 instead of $2.54.[185] AGA's table shows increased production in the fourteen fields of about 2.3 Tcf as a result of eliminating vintaging rather than the 7.2 Tcf found by Shell and the 5.7 Tcf found by DOE.

However, even accepting these criticisms and using the data suggested by the AGA as more accurate than that used by DOE for expected market prices, current reserves, field pressure, and abandonment pressure,[186] there

[182] These figures are also criticized as being estimated based on field depth, rather than being the actual field pressures.

[183] *See* MPC/NASUCA at 12.

[184] *See* APA, Appendix A at 1.

[185] *See* AGA, Appendix A.

[186] AGA's suggested data for current abandonment pressure presumably take into account its contention that pipelines will absorb certain costs including compression, and that the producer may continue operating the well even after costs outstrip revenues in order to avoid the costs of plugging the wells.

would be an increase in reserves for the fourteen fields of about 2.3 Tcf compard to the 5.7 Tcf predicted by DOE.[187] This is still a significant increase. In any event, the Commission believes that a number of the commenters' criticisms of the data used by DOE are unjustified and that AGA's data contains errors causing it to understate significantly the likely supply response. First, AGA assumes that prices will rise to only $1.90 per Mcf after elimination of vintaging. While $1.90 may be an accurate estimate of the prices producers could obtain at the present time, the problem here is to estimate the increase in recoverable reserves which would occur over the next ten or more years. For this purpose, estimated average prices over the next ten or more years should be used, not currently depressed spot market prices which are unlikely to continue over the long term.[188] The Commission believes that DOE's use of $2.52 per Mcf in 1985 dollars is more realistic than AGA's use of $1.90. While DOE's assumed price is not projected to occur until 1990, abandonment decisions are not based solely on current prices. Rather, a producer abandons a well when total predicted future costs are greater than total predicted future revenues. Thus, a producer might delay abandonment if it expects higher prices in the future. The majority of abandonment decisions will be made after 1990 in any event since old gas is not expected to be exhausted for approximately forty years.

Another error made by AGA is the fact that its figures are current reserves and field pressure mix 1981 and 1985 data. All but one of the reserve figures are for 1985, but only about half of the pressure figures are. This leads AGA to a further understatement of the predicted increase in recoverable reserves. This is because the Shell methodology calculates the predicted increase in

[187] *See* Table 2 of Appendix A to AGA's initial comments.

[188] OTA in its study emphasized the importance of using long-term, rather than short-term, prices. OTA study at 34-35.

recoverable reserves as a fraction of the total reserves remaining in the field at any particular time.[189] Generally, it makes no difference in the predicted increase in reserves at what time in the life of the field the figures for current reserves and pressure are taken, so long as consistent data are used. Both a field's reserves and pressure decline over time. While a lesser amount of remaining reserves would mean a lower predicted increase in reserves all other variables remaining the same, lower current pressure leads to a higher predicted fractional increase.[190] Thus, any decline in reserves resulting from using data for a later period in the life of the field is counterbalanced by the greater fractional increase in reserves resulting from lower current pressure. It follows that the commenters' criticism of Shell and DOE for using 1981, rather than current, data is unjustified. However, AGA's use of figures from different time periods distorts its results. For about half the fields, AGA fails to counterbalance use of the lower 1985 reserves figures with lower 1985 abandonment pressures. Instead, it uses the

[189] Specifically, Shell and DOE calculate the increase in recoverable reserves is calculated as follows:

where:

A = remaining reserves in field

B = abandonment pressure at current prices

C = abandonment pressure at new prices

D = current field pressure

E = increase in recoverable reserves

$$A \times \frac{B - C}{D - B} = E$$

[190] Pursuant to the formula set forth in the preceding footnote, the fractional increase is

$$\frac{B - C}{D - B}$$

Since current field pressure is D, lower pressure, means a lower denominator in the fraction, thereby increasing the fraction.

higher 1981 abandonment pressure figures, thus leading to a lower predicted fractional increase than if it had used 1985 abandonment pressures.

The Commission concludes that the commenters' criticisms of the data used by DOE in determining the increases in recoverable reserves in the fourteen fields do not undermine the essential conclusion that an increase in price to the post-1974 ceiling would cause a substantial increase in recoverable reserves in those fields. The Commission notes that some of the data, in particular the estimate of the pressures at which fields will be abandoned, is by its nature uncertain. Subjective engineering judgments are required, as OTA observed. Thus, no prediction of the increase in recoverable reserves in the fourteen fields can be exact. At best, one can predict a range within which the increase is likely to fall. The Commission believes that AGA's prediction, if adjusted for the errors discussed, would represent a prediction at the low end of the range. Even so, there would be a significant increase in recoverable reserves in the fourteen fields.

Once increased production from the fourteen fields as a result of an increase in price has been estimated, there remains the problem of extrapolating the nationwide increase. Furthermore, the predicted increase for the fourteen fields does not take into account the fact that some old gas may qualify for NGPA incentive or deregulated prices and thus be produced regardless of the elimination of vintaging or that other old gas, such as that subject to fixed price clauses, may not receive an increased rate, and thus may not be produced in any event. Opposing commenters contend that the Shell and DOE studies do not deal with these problems adequately. While the Shell study appears not to, the Commission believes that the DOE study did.

The 1983 Shell study dealt with both these problems simultaneously when it multiplied the predicted fourteen

field increases by the ratio of January 1981 national reserves responsive to decontrol [191] to January 1981 reserves in the fourteen fields.[192] DOE, however, in light of OTA's criticism of Shell's methodology, addressed separately the problems of scaling the fourteen field results to the national level and adjusting for the fact that the fourteen field results include non-responsive gas. With regard to the first problem, OTA noted that Shell's use of the ratio of remaining national reserves to remaining reserves in the fourteen fields could cause distortions if a different percentage of the gas in the fourteen fields had been produced than that of the nation as a whole.[193] For example, if the fourteen fields were less depleted than the national average, the scaling factor would be too large.

In order to avoid these possible distortions, OTA suggested use of the ratio of ultimate national reserves [194] to ultimate reserves in the fourteen fields. As OTA said, the reserve response from increased prices is a function of the true physical size of the field, not the amount of gas that happens to remain at any one time. DOE followed OTA's suggestion and scaled the fourteen field results to the national level by a ratio based on ultimate reserves. In fact, the fourteen fields do appear to be less depleted than the average fields so that use of a scaling factor based on remaining reserves tends to underestimate

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[191] It calculated those reserves to be 115 Tcf as follows. From January 1, 1981 national wet gas reserves of 206 Tcf, it subtracted 33 Tcf for North Slope gas, 20 Tcf for gas dissolved in oil, and 20 Tcf for water drive reservoirs. Based on AGA data for newly discovered reserves, it estimated that about 85% of the remainder, or 115 Tcf, was old gas that would respond to deregulation.

[192] The ratio used for purposes of extrapolating from the fourteen field results an estimate of nationwide increased recoverable reserves is is referred to as the "scaling factor."

[193] *See* OTA study at 45-46.

[194] Ultimate reserves equal proved reserves plus cumulative production.

the national increase in recoverable reserves due to elimination of vintaging. The scaling factor obtained by DOE is 3.5 [105] as opposed to Shell's scaling factor of 2.8. AGA failed to correct for this distortion, but continued to use a scaling factor based on remaining reserves. Thus, for this reason alone, its methodology underestimates the increase in recoverable reserves resulting from adoption of this rule.

Having extrapolated the fourteen field results to a national level, DOE, like OTA, then addresses the problem of adjusting the predicted increase in reserves to include only that increase which would occur as a result of elimination of vintaging. First, DOE recognizes that some increased production would occur in any event under the existing section 108 incentive prices for stripper wells.[106] DOE estimates that such production accounts for about four percent of the estimated increase and subtracts that amount from its estimate of the total increased production resulting from elimination of vintaging.[107] Thus, it

[105] In light of OTA's statements that Shell's data for the ultimate reserves of both the nation and the fourteen fields might be unreliable, DOE used for ultimate reserves the lower-48 states estimate for Dec. 31, 1977, reported in Reserves of Crude Oil, Natural Gas Liquids, and Natural Gas in the United States and Canada—1979, American Petroleum Institute/America Gas Association, Volume 34, June 1980. DOE based its figure for ultimate reserves in the fourteen fields on a 1980 study prepared for the AGA and presented by it to OTA. *See* OTA study at 73.

[106] OTA criticized Shell for failing to take this into account. OTA study at 49-51.

[107] In its May 1986 study analying DOE's proposed rule (*see* note 181, *supra*), EIA stated that production from stripper wells accounts for only about 2.3 percent of annual U.S. production. EIA concluded that the NGPA incentive price for stripper gas has not resulted in significant additional supplies of gas, and therefore EIA made no adjustment in its prediction of increased supplies due to delayed abandonment to account for gas which would be produced in any event under stripper prices. Thus, the EIA study supports DOE's estimate that no more then 4 percent of increased

is not true, as some commenters contend, that DOE has not accounted for the production which would occur in any event pursuant to section 108 stripper prices. Second, in order to account for other gas that would also receive adequate prices to stimulate full economic production under current regulations, DOE made a further, more significant adjustment to the predicted increase. While the 1983 Shell study had calculated a January 1, 1981 responsive reserve base of 115 Tcf, DOE estimated that, in fact, only about 66 Tcf of old gas would not receive adequate prices under current regulations but would respond to higher prices, as of January 1, 1981. Accordingly, DOE scaled down its estimate of increased production by 66/115, or about 57 percent, to achieve its final estimate of 11 Tcf.

DOE's estimate of responsive reserves is at the low end of OTA's estimated range of 65 to 75 Tcf and is based on a methodology suggested by OTA. Relying on data in a study prepared for AGA,[108] DOE determined the percentages of each category of old gas likely to respond to higher prices allowed by eliminating vintaging. It then multiplied the amounts of old gas in each category as of December 31, 1980, by these percentages and totalled the results.

AGA contends that the responsive reserve base is only 45.5 Tcf, as opposed to DOE's estimate of 66 Tcf.[109]

production as a result of higher prices would occur pursuant to NGPA stripper prices.

[108] *Trend in Natural Gas Purchases by NGPA Category*, Foster Associates (for the AGA), May 1983.

[109] AGA apparently assumes that only proven reserves committed to interstate commerce at the time the NGPA was enacted would respond to elimination of vintaging. It therefore takes 1978 national proven reserves and subtracts North Slope gas, gas associated with oil, water drive gas, and all intrastate gas to obtain 1978 year-end reserves affected by decontrol of about 95 Tcf. It then estimates the amount of such gas produced since 1978 as

However, the Commission considers DOE's estimate more accurate than AGA's for present purposes. AGA makes at least two errors in its analysis. First, it subtracts all intrastate gas. However, in light of the fact that contracts for the sale of some intrastate gas are keyed to Federal price ceilings and that the Comission is amending the DOE proposal to allow intrastate rollover gas to qualify for higher prices, inclusion of some intrastate gas appears appropriate. Second, and more important, AGA has subtracted from reserves all production through 1985. However, Shell's 115 Tcf represents an estimate of national reserves as of January 1, 1981. This allowed Shell to use consistent data in extrapolating its results from the fourteen fields to the national level, since its figures for reserves in the fourteen fields were also for January 1, 1981. Obviously, use of 1985 national reserve figures for this purpose would result in too low a scaling factor unless the reserves for the fourteen fields were also reduced to account for 1981-1985 production from those fields. For similar reasons, DOE correctly used December 31, 1980 reserves in adjusting for Shell's overestimate of responsive reserves. As explained above, DOE scaled down its prediction of increased production by the ratio of its estimate of responsive reserves to Shell's. Since Shell's was an estimate for January 1, 1981, consistency required DOE to use an estimate for the same period.

For all the reasons stated above, the Commission concludes that elimination of vintaging will substantially increase recoverable old gas reserves and that DOE's 11 Tcf estimate of that increase is a reasonably reliable estimate. The Commission recognizes, as emphasized by OTA, that no estimate of the increase in recoverable reserves can be exact. Much of the data used in making the estimate is itself estimated, including abandonment

about 50 Tcf. Subtracting this from the 95 Tcf gives 1986 reserves affected by decontrol of about 45 Tcf.

pressures in the fourteen fields and the amount of reserves responsive to elimination of vintaging. Also, the increase in production depends in part upon uncertain future market prices which will determine the producers' ability to charge up to the new ceiling price. Nevertheless, even if the increase in recoverable reserves cannot be quantified exactly, the Commission finds that there is a direct relationship between price levels and the length of time operation of a well remains economic. Pre-1975 gas will receive a substantial price increase as a result of the rule. That price increase will cause a substantial increase in recoverable reserves through delayed abandonment. The inability to quantify exactly that increase does not vitiate the Commission's finding that it will occur.[200] If producers do not collect at the full ceiling price, reserve additions may not be as substantial but any potential negative impact on consumer prices will likewise be less.

This substantial increase in the production of old gas will benefit the public interest. Apart from the fact that in a workably competitive market it will displace higher cost gas, thus causing overall consumer prices to decline (which will be discussed in more detail in the next section), it will have other benefits. It will aid national security since any increase in domestic gas production reduces the nation's dependence on foreign oil and gas. The less oil and gas we import, the less dependent our economy is on uncertain imports of oil and gas from unstable areas. Also, reducing imports of foreign oil will reduce trade imbalances.

Some commenters have argued that, even assuming DOE's estimate of increased production is correct, the incremental cost of that production would be exorbitant and therefore such production would not be beneficial. For example, United Distribution Companies has pre-

[200] *See Mobil Oil Corp. v. FPC*, 417 U.S. 283, 318-19 (1974).

sented a study purporting to show that the incremental cost of the additional old gas supplies would be from \$3.75 to \$5.77 per Mcf in 1985 dollars depending on whether prices for old gas rise to the new ceiling or to a lower market price.[201] These commenters obtain their high incremental cost estimates for additional old gas by determining purchasers' increased cost of purchasing all old gas as a result of this rule and dividing the result by DOE's estimated increase in recoverable reserves. This calculation fails to take into account the reduction in price of higher cost gas which will occur as a result of this rule. As discussed in detail in the next section, the Commission believes that increased production of old gas will reduce overall consumer costs by delaying the need for exploration and development of higher cost gas. This being the case, it is clear that the claims of a high incremental cost for the increased production are invalid.

Overall the only certainty about future natural gas supplies is their extreme uncertainty. The Commission notes that two recent authoritative studies predict that production of natural gas from conventional sources within the lower 48 states could range from 14 to 20 Tfc in 1990 and 9 to 19 Tcf by the year 2000, compared to current production of 17-18 Tcf annually.[202] These studies confirm that the key variables in such projections—price and demand—are highly uncertain and insusceptible of accurate prediction beyond the very short-term.

The Commission does draw several general quantitative and qualitative conclusions from current data on natural gas supplies:

1. Natural gas supplies are adequate for the short-term, but the Commission is obligated to establish rates

[201] See UDC reply comments, Appendix A.

[202] OTA Study, *supra* at p. 6; AGA Gas Supply Committee Report, *supra* at p. 7.

which call forth adequate supplies for the long-term as well. The current surplus is one of deliverability, not reserves. Although surplus deliverability is reported at an annual level of 3 Tcf, lower-48 proved domestic reserves have declined from 291 Tcf to 197 Tcf since 1970.[203]

2. Even after seven years under the NGPA, 90 percent of gas well completions have been in regions thought to contain only 30 percent of remaining reserves. On the other hand, 63% of our remaining reserves are in "hard to develop" areas—such as Alaska, offshore, or at depths below 15,000 feet.[204] This means that future gas exploration and production will inevitably be more expensive, in real terms, than current production.

3. The risks and costs of exploratory drilling and development of gas reserves in frontier areas, such as the OCS and deep formations, are greater than the likely costs of increased production through delayed abandonment of old gas.[205] Delayed abandonment of old gas is only possible under higher prices, and will enhance more efficient timing of, and investment in, natural gas exploration, development and production. This is because, although delayed abandonment cannot substitute for reserve replacement over the long-term, it can postpone more costly investments in exploration and development of frontier gas areas over the near term by increasing the supply of lower-cost gas.

[203] EIA, *Natural Gas Monthly, supra* at Table 6 (February 1986); EIA, *U.S. Crude Oil, Natural Gas, and Natural Gas Liquids Reserves, 1984 Annual Report* (September 1985), *supra*. In addition, if the recent collapse in oil and gas drilling and drastic reduction in exploration and development budgets persists, reserve replacement in 1986 and subsequent years can be expected to decline on a more accelerated basis, unless the existing price structure for old gas is revised.

[204] AGA Gas Supply Committee Report, *supra* at p. 6.

[205] OTA Study, *supra* at pp. 7-10.

4. Investment in exploration and development of gas reserves is most efficient if it is made on the basis of long-term risk and return, rather than on the basis of short-term prices in gas markets. This is because oil and gas exploration is risky, and development of reserves requires long-term security of financing. The experience of deep gas drillers under thet NGPA proves that short-term perceived shortages in gas markets are no substitute for long-term considerations, such as growth in the general economy and potential fuel substitution. For this reason, the best time to raise old, flowing gas prices is in the midst of a perceived short-term surplus, such as today, because future producer investment will be more efficiently allocated to those projects with the best long-term return to gas purchasers, rather than those more costly projects which would be required absent this rule.

For these reasons, the Commission concludes that the new just and reasonable rate in the final rule will enhance efficient investment in the replacement of domestic natural gas reserves over the long-term, in response to competitive wellhead markets.

E. Effect of Higher Old Gas Prices on Overall Gas Prices

Comment Summary. DOE, producers, their trade associations, public service commissions representing producer states, and some industrial and other larger end-users contend that the proposed rule will reduce overall natural gas prices. They assert that the increased production of old gas resulting from elimination of vintaging will displace more costly new and imported gas. This will place strong downward pressure on the price of that gas. Furthermore, the expectation of lower future prices will cause some producers to shift production of some less costly reserves to earlier periods when prices are relatively higher. This will add to the downward pressure on current prices. At the same time production of higher

cost reserves will be delayed, further reducing costs to consumers.

Elimination of the old gas cushion, which currently subsidizes above-market prices for some gas, will reinforce these downward pressures on the price of high-cost gas. Purchasers will no longer be willing or able to pay above-market prices for new and high-cost supplies. Producers will have to reduce the price of that gas or face a significant loss of sales. In short, both producers and purchasers will find it mutually advantageous to renegotiate high-cost contracts in order to market the gas. DOE's computerized mathematical model of the United States natural gas market predicts that the decrease in prices to consumers will range from 19¢ to 55¢ per Mcf during the period 1986 to 1995.

Pipelines, distributors, and consumer representatives all dispute the contention that overall prices will decline. They assert that the claim of a price decline is based solely on economic theory and is without factual support. They argue that the elimination of vintaging will cause a huge increase in prices to consumers. Elimination of vintaging allegedly will cause almost all pre-1975 gas, which currently sells for an average of approximately $1.26,[206] to rise at least to the current market price of about $2.00. However, the increased cost of pre-1975 gas will not be offset by reductions in the cost of other gas.[207] Post-1974 old gas will remain at its $2.57 ceiling price since there is no provision in the rule for renegotiating the price of that gas down to market levels. New gas, which is sold under market responsive contracts, has already been reduced to approximate market levels and cannot be expected to decline much further. New gas sold under non-market responsive pricing provisions including take-or-pay clauses also will not come down in price since

[206] DOE, Appendix C at 3.

[207] AGPA at 21-24.

producers have no incentive to renegotiate such contracts. Opposing commenters state that the fact pipeline WACOGs remain substantially above the spot market price of gas demonstrates pipelines' inability to renegotiate take-or-pay contracts. Since a surplus of natural gas lasting over two years has not forced renegotiation of inflexible contracts to market levels, the production of still more gas is not likely to have that effect.[208]

Both AGA and INGAA have presented studies asserting that in the absence of significant renegotiation of non-market responsive contracts, interstate pipeline WAGOGs will rise substantially.[209] Many individual pipelines and their customers have presented analyses calculating the increase in their pipeline's WACOG if DOE's proposed rule is adopted. A number state that even a reduction in price of the pipeline's high-cost gas to market levels would not offset the increased cost of old gas.[210]

Finally, opposing commenters state that DOE's proposed rule will have a particularly adverse impact on captive (primarily residential) consumers.[211] The increased prices pipelines will be forced to charge their customers will encourage those who can to buy cheaper gas on the spot market. These customers are primarily large industrial users, electric utilities and some distributors. The remaining customers will have to bear a larger share of the pipeline's fixed costs and take-or-pay liabilities.

Commission Response. The Commission believes that the more accurate price signals and increased supply of

[208] *See*, for example, MPC/NASUCA at 17.

[209] AGA, Appendix B. INGAA at 32-38.

[210] *See*, for example, the comments of KN Energy, Inc.; Natural Gas Pipeline Co. of America; El Paso Natural Gas Co.; Peoples Gas Light and Coke Co.; Northern Illinois Gas Co; and Citizen/Labor Energy Coalition at 24-25.

[211] *See*, for example, UDC Appendix A at 37-38.

old gas encouraged by the elimination of vintaging will reduce natural gas prices below what they would be with continued vintage-based pricing. Because the additional old gas is produced by continuing the operation of existing wells, the costs of producing that gas will be less than the costs of producing new gas. New gas is generally produced either through drilling for and discovering new sources of gas or applying expensive development techniques to existing fields. In addition, the transmission cost of the old gas is generally less than that of the new, since the old gas is already connected to a pipeline. The Commission believes that in today's highly competitive market, an increased supply of low-cost gas, and more accurate prices signals for all gas, will reduce prices to pipelines and consumers.

Commenters who claim prices will rise rely on an assumption that the natural gas market is not fully competitive. That is the only basis for contentions that, in spite of the loss of the old-gas cushion, take-or-pay clauses will prevent high-cost gas from falling in price. The Commission believes, however, that the market for wellhead natural gas sales is workably competitive. In the first place, Congress so found when it enacted the NGPA. Implicit in the removal of the Commission's authority to regulate the price of new gas is a finding that the wellhead market for natural gas is competitive. As the court stated in *Pennzoil v. FERC*, 645 F.2d 360, 378-79 (5th Cir. 1981), "Contrary to the Supreme Court's assumption in *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954), which subjected gas producers to utility-type regulation under the NGA, Congress apparently decided that gas producers do not have 'natural' monopoly power." Similarly, in *Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Board of Mississippi*, 106 S. Ct. 709, 717 (1986), the Supreme Court stated, "the NGPA reflects a Congressional belief that a new system of natural gas pricing was needed to balance supply and demand. . . . The new federal role is to 'overse[e]' a

national *market price* regulatory scheme'" (emphasis added).

Congress' determination that wellhead markets are workably competitive has been borne out by experience under the NGPA and strengthened by past Commission decisions. In the past two years, as a surplus of natural gas has developed, market forces have significantly reduced overall prices paid by pipelines for gas. As shown below in Table 1, WACOGs of the major interstate pipelines have fallen from $2.84 in February 1984 to $2.51 in February 1986.

Table 1

Trend in Projected Decontrolled Gas Prices and Pipeline WACOGS: 30 Major Interstate Pipelines [a] ($/MMBtu)

Month Year (1)	*107 Deep Gas* (2)	*Other Decontrolled Gas* (3)	*Total Field Purchases* (4)	*Canadian Imports* (5)	*Total Purchases* [b] (6)
2/84	$5.82	—	$2.75	$4.58	$2.84
4/84	5.45	—	2.73	4.63	2.88
6/84	5.45	—	2.74	3.96	2.84
8/84	5.42	—	2.75	3.86	2.84
10/84	5.47	—	2.77	3.79	2.84
12/84	5.29	—	2.76	3.91	2.85
2/85	5.16	$3.67 [c]	2.76	3.70	2.84
4/85	4.85	3.63	2.72	3.53	2.80
6/85	4.60	3.52	2.66	3.40	2.72
8/85	4.43	3.38	2.60	3.20	2.66
10/85	4.40	3.28	2.57	3.20	2.64
12/85	4.31	3.19	2.47	3.04	2.55
2/86	4.21	3.09	2.44	3.02	2.51

[a] Gas prices and WACOGs beginning 2/84, 4/84, 11/84, 1/85 and 6/85 are for 24, 26, 28, 29 and 30 pipelines, respectively.

[b] WACOGs exclude inter-pipeline transactions.

[c] Effective 1/1/85 sections 102(c), 103 wells deeper than 5,000 ft., and 107(c)(5) were decontrolled.

Source: PGA filings of interstate pipelines effective as of the date shown as tabulated in Foster Associates' *Current Purchased Gas Costs of Interstate Pipeline Companies* (monthly).

The price of all gas decontrolled under the NGPA has fallen from $3.67 in February 1985 to $3.09 in February 1986. In addition, the price of gas still subject to price ceilings has fallen substantially below those ceilings. For example, in November 1984 the ceiling price for price-controlled section 102(d) gas was $3.82 and the actual price was $3.78. By February 1986, the ceiling price was $4.19 but the average price had fallen to $3.24.[212] As shown below in Table 2, since November 1985 pipelines have been regularly marketing out under contracts in all NGPA categories at prices significantly below the post-1974 gas ceiling price.

Table 2

Date (1)	*Pipeline* (2)	*NGPA Categories Affected* (3)	*New Price* (4)	*Notes* (5)
11/85	Mid-Louisiana	All	2.25	
11/85	Houston Natural Gas	All	2.20	Gas well gas.
11/85	Northwest Pipeline	All	2.58	85% of No. 6 Seattle/ Portland.
11/85	Texas Gas Transmission	All	2.25	
11/85	Transcontinental Gas P.L.	All	2.15	
11/85	United Gas Pipe Line	All	2.00	Includes taxes.
1/86	ANR Pipeline	All	2.10	Includes taxes.
1/86	Colorado Interstate Gas	All	2.15	
1/86	Columbia Gas Transmission	All	2.70 2.50	Appalachian SW, Rockies, Mid-Cont.
1/86	Natural Gas Pipeline	All	1.90	Includes taxes.
1/86	Northern Natural Gas	All	2.35	Floor
2/86	Florida Gas Transmission	All	1.90	Not to exceed 65% of No. 6 oil.
2/86	Transwestern Pipeline	All	2.50	
4/86	Northwest Pipeline	All	2.08	
4/86	Southern Natural Gas	All	2.06	
4/86	El Paso Natural Gas	All	2.20	

Source: Indicated Producers Reply Comments, Appendix E at 9.

[212] Indicated Producer's reply comments, Appendix E at 8.

The competitive forces bringing down the price of gas include not only competition in producer markets among suppliers of natural gas, but also competition in consumer markets among suppliers of gas and alternative fuels including residual fuel oil. As the prices of crude oil and residual fuel oil have fallen, producers and pipelines have had to reduce their prices in order to remain competitive and avoid losing markets. Many natural gas customers can easily switch to alternate fuels if these fuels became cheaper than gas. For example, electric utilities can burn residual fuel oil in some boilers now burning gas. A number of large industrial and commercial customers can also switch fuels.[213]

It is true, as observed by opposing commenters, that pipeline WACOGs continue to average above the spot market price of gas ($2.42 per MMBtu as opposed to $1.90 to $2.00 per MMBtu).[214] However, this fact does not negate the conclusion that the natural gas market is workably competitive. First, in a competitive market, spot market prices should be different than overall prices. Spot market sales are short-term sales. Purchasers will generally have to pay higher prices for long-term sales since such sales give them greater security of supply. Furthermore, contracts entered into immediately after the NGPA was enacted were negotiated at a time of serious natural gas shortages caused at least in part by earlier rigid, cost-based regulation of wellhead prices under the NGA. Pipelines were just emerging from a period of curtailments and were anxious to replenish their reserves. The result was that new gas was purchased at the applicable NGPA maximum lawful prices and even higher prices were paid for price-deregulated supplies. These high prices increased supply and reduced

[213] Increasing Competition in the Natural Gas Market. The Second Report Required by section 123 of the Natural Gas Policy Act of 1978 (January 1985).

[214] *See*, for example, MPC-NASUCA at 16, 17.

demand, converting the shortage into a surplus. This has brought about today's lower market prices, demonstrating that the natural gas market is workably competitive. To the extent overall prices remain above spot market prices, it is largely because pipelines continue to have contracts entered into during the earlier period of shortage. Furthermore, the existence of the old-gas cushion has permitted the price of new gas sold under non-market responsive contracts to remain at higher levels. However, in a market characterized by surplus deliverability and intense interfuel competition, supplies of gas cannot sustain above-market prices even under existing contracts, and elimination of the old gas cushion will put added pressure on already-declining high-cost gas prices, which in time will reduce pipeline WACOGs.

Given the fact that the wellhead natural gas market is workably competitive, and that the Commission is allowing for the renegotiation of all gas in contracts containing any old gas under the good faith renegotiation rule, the Commission is unconvinced by the opposing commenters' contentions that prices will rise if vintaging is eliminated. These contentions are all based, in one form or another, on the assumption that prices for pre-1975 gas will rise substantially, and relatively high-cost gas will not decline sufficiently to offset this increase. However, this cannot happen in a competitive market. The opposing commenters contend, for example, that new high-cost gas sold under market responsive contracts[215] cannot be expected to decline in price very much since it has already been reduced approximately to market levels.[216] However, the current market price of such gas

[215] These contracts were entered into primarily after 1982 and, according to INGAA (at page 30), account for approximately 25% of all gas.

[216] INGAA (at 30) estimates that the price of such gas now averages about $2.35.

takes into account the old-gas cushion. Once the cushion is removed, and pipelines pay more for pre-1975 gas, competition will require pipelines to seek a lower price for high-cost new gas. Where contracts for sale of new gas have market-out clauses, pipelines clearly have the ability to force down the price of such gas and any assumption that the price of this high-cost gas cannot decline significantly is unrealistic.

Opposing commenters also contend that high-cost gas sold under so-called non-market responsive contracts [217] cannot come down in price. These commenters claim that producers will have no incentive to renegotiate high-cost contracts. They state that pipelines cannot link renegotiation of take-or-pay obligations to allowing increased prices for the old gas, since if they do producers can simply sell the old gas to someone else. Furthermore, they state that Order No. 436 prohibits pipelines offering non-discriminatory transportation from refusing to transport the gas to a third party unless the producer grants take-or-pay relief. The Commission believes, however, that the elimination of the old-gas cushion, together with the increased production of low-cost old gas, will accelerate renegotiation of the price of substantial volumes of that gas. Producers and pipelines will simply have to renegotiate lower prices for this gas in order to avoid a significant loss of market to lower-priced gas and alternate fuels.

Opposing commenters' contentions concerning the impossibility of renegotiating contracts for the sale of this gas are unconvincing. In April 1985, the Commission issued a policy statement, reaffirmed in Order No. 436, stating that pipelines may buy out their take-or-pay liability without violating NGPA ceiling prices and that the Commission will grant expedited treatment of abandonment requests necessary to implement take-or-pay buyouts.[218] Pipelines have been successfully renegotiating their take-or-pay contracts pursuant to the April 1985 policy statement. For example, in Order No. 436, the Commission noted that its records disclose eight settlements by major pipeline companies discharging \$421,275,035 in take-or-pay liability for \$80,761,007 or less than 20¢ on the dollar.[219] NGSA has presented a table showing nine settlements discharging take-or-pay liabilities of \$3,626,275,035 for \$435,461,007, or about 12¢ on the dollar.[220] An NGSA survey of producers shows that they have settled over two thirds of their outstanding take-or-pay liabilities and that most of the remaining liability is of recent origin.[221] Finally, a survey of interstate pipeline financial statements filed with the Securities and Exchange Commission shows pipelines repeatedly stating that they expect to renegotiate take-or-pay contracts.[222] Thus, pipelines have been able to renegotiate high-cost take-or-pay contracts for new gas.

The Commission believes that elimination of vintaging can only accelerate this process. Pipelines will be able for the first time to offer higher prices for old gas in return for voluntary renegotiation of take-or-pay contracts. In addition, since there will no longer be an old-gas cushion available to protect high-priced contracts through rolled-in pricing, both pipelines and producers will find it mutually advantageous to renegotiate such contracts in order to retain a market for their supplies in the face of competition from cheaper gas and alternate

[217] These contracts were primarily entered into from 1978 through 1981 and, according to INGAA, cover about 28% of all gas.

[218] *See* 18 CFR 2.76 and 2.77(a)(1) (1985).

[219] 50 FR 42408, 42464 (October 18, 1985).

[220] *See* NGSA reply comments, Appendix B, Attachment 3.

[221] *See* NGSA reply comments, Appendix B, Attachment 1. The survey shows that settled liabilities equal \$5,698 billion, while unsettled liabilities equal \$2,552 billion.

[222] Indicated Producers Reply comments, Appendix C.

fuels. Furthermore, in cases where pipelines threaten to stop purchases by invoking the *force majeure* provisions of their contracts, producers may prefer the certainty of receiving the market price to the delay and uncertainty of litigation in attempting to enforce high-price take-or-pay contracts.[223] The Commission therefore rejects the assertion that high-cost gas sold under take-or-pay contracts will not come down in price in response to the elimination of vintaging.

Moreover, while the Commission believes that high-cost non-market responsive gas under all contracts would come down in price gas even under the rule as proposed by DOE, the Commission is modifying the good faith negotiation rule in order to give the purchaser the right to renegotiate gas prices on a contract-by-contract basis under that rule. Specifically, the Commission is providing that where the producer requests the purchaser to nominate a new price for old gas in one contract, the purchaser may request the producer to nominate a new price for any new gas in that contract or in any other contract between the parties which also contains old gas. If the purchaser rejects the price nominated by the producer, it may discontinue purchases of that gas upon thirty days notice. This modification of the good faith negotiation rule provides the purchaser a powerful additional bargaining card to negotiate a lower price for new gas in multi-vintage contracts including those which are not market-responsive and buttresses the Commission's conclusion that the average price of high-cost gas will be significantly reduced under this rule. The Commission therefore rejects the assertion that high-cost gas sold under take-or-pay contracts will not come down in price in response to the elimination of vintaging.

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[223] *See, e.g.*, various "released" gas programs undertaken by many pipelines, in which they take substantial volumes of new and high-cost gas in exchange for price relief.

Opposing commenters also assert that post-1974 gas will remain at its $2.57 ceiling price since there is no provision in the rule as proposed for renegotiating contracts covering that gas. The Commission believes, for the reasons already amply stated above, that even in the absence of market-out clauses in the contracts for the sale of this gas, competitive forces released by the elimination of vintaging will work to lower the price of post-1974 gas so long as overall market prices remain below the ceiling price for this gas. However, in order to provide that renegotiation of old gas prices under the good faith negotiation rule is undertaken on a generic basis, the Commission's modification of DOE's good faith negotiation rule will provide additional assurance that this occurs. Under the rule as modified, where a producer requests its purchaser to nominate higher prices for any old gas, the purchaser may request the producer to nominate lower prices for old gas which the purchaser believes is being sold at above-market prices. The modification of the good faith negotiation rule thus assures that all old gas will be market-responsive and will assure that all old gas will be priced at a market-clearing level. There is no merit to commenters' arguments that the ceiling price for post-1974 gas, which this rule makes applicable to all old gas, will act as a floor for the price of old gas. The evidence cited previously that pipelines are currently marketing out on gas at prices well below the post-1974 ceiling price demonstrates that in today's competitive natural gas market that ceiling does not act as a price floor.

Elimination of vintaging will reduce overall prices below what they otherwise would have been by increasing production of cheaper gas and eliminating the old-gas cushion. This conclusion is supported by the movement of gas prices following partial decontrol of natural gas on January 1, 1985. Before decontrol, there were predictions of a price fly-up unless actions were taken to deal with take-or-pay contracts and to cap indefinite price

escalators.[224] Yet no such fly-up occurred. In the first year after partial decontrol, natural gas prices at the wellhead declined by 33¢ per Mcf. This demonstrates that the natural gas market is sufficiently competitive that removing price ceilings does not cause an increase in prices. The forces of the market-place require producers and purchasers to keep their prices at market clearing levels so as to avoid loss of sales. The fact that oil prices have declined since oil prices were decontrolled in January 1981 is further evidence that removal of price ceilings in a competitive market does not cause price increases.

Finally, the Commission observes that eliminating vintaging will not only reduce prices below what they otherwise would have been, it will make prices more stable. When the current surplus is dissipated,[225] natural gas prices will rise in order to encourage producers to produce the additional gas necessary to satisfy demand. So long as current old-gas price ceilings remain in effect, the entire additional supply increase must come from new gas. Thus, new-gas prices would have to increase substantially. However, if vintaging is eliminated so that a supply response will occur for old gas, then new-gas prices will not have to rise dramatically to encourage

[224] For example, in April 1984, INGAA issued a study entitled "Analysis of Price Fly-Up under the Natural Gas Policy Act," in which it stated, "In the absence of significant renegotiation or a legislative solution, non-market sensitive price and take provisions in existing contracts will push the average wellhead price up by 9% to 12% above inflation in 1985." Significantly, the INGAA fix-up prediction was based on the same incorrect assumption made by similar comments in this rulemaking: that producers will automatically collect the highest prices authorized by indefinite price escalators in their existing contracts, despite competitive market conditions.

[225] DOE predicts a dissipation of the surplus by 1988 under current regulations. The surplus could be dissipated by 1987 if vintaging is eliminated because the natural gas market will operate with greater efficiency.

exploration and development since some of the necessary supply response will be obtained through higher prices for old gas. In short, more gas will be made responsive to the market, prices will be more stable, and the tendency toward inefficient price disparities in the natural gas market will be reduced.

Commenters have included numerous studies and statistics in the record concerning the likely impact of the DOE proposal on consumers. To the extent they illustrate the wide mixture of old gas, new gas, and non-market responsive gas on individual pipeline systems, these studies are helpful. Over 20 years of vintaging have splintered the old gas "cushion" into as many pieces as there are different pipeline systems. This unequal access to the cushion means that the Commission must take into account the transitional impacts of the final rule on individual pipeline systems, as well as its long-term impacts nationwide.

However, many of these studies commit the fundamental error of assuming that, on a pipeline-by-pipeline basis, wellhead markets are static and do not change in response to changing city-gate and burner-tip markets. For example, a number of commenters in this docket have assumed that old, flowing gas prices will *immediately and automatically* rise to the highest price permitted by the final rule, but that existing high-cost gas prices will *not* be renegotiated downward commensurately.[226]

These studies beg the question. The real question is not *whether* high-cost prices will come down in response to higher old gas prices, it is *how fast* they will come down. Nor is it a question of the impact of the rule on a *pipeline's* gas acquisition costs *per se*. Instead, the NGA requires the Commission's ultimate concern to be

[226] *See, e.g.*, Initial comments of INGAA, AGA, Northern Natural, Natural Gas Pipeline of America, Panhandle Eastern, Southern Natural, Northwest Central, KN Energy.

protection of *consumers* downstream from the wellhead, and therefore it must seek a balance of risks and return at the wellhead which achieve this goal.

For this reason, the Commission has analyzed the evidence in the record as to how quickly existing wellhead prices, especially those for new gas, can respond to changes in city-gate and burner-tip markets. In addition, the Commission has scrutinized the current and past purchased gas adjustment filings ("PGAs") made by the 20 major interstate pipelines. The most current PGA data, included in the record, breaks down for each pipeline its purchased gas costs by NGPA pricing category, volumes, weighted average cost, and major producer-suppliers. Past PGA data, compiled by EIA, indicates the trend of high-cost prices under NGPA section 102 and section 107 on major pipeline systems between early 1983 and the present.[227]

These tables indicate that high-cost gas WACOGs have trended *substantially downward* since 1985 following the partial deregulation of these wellhead categories mandated by the NGPA on January 1, 1985.

However, because pipelines are only required to file PGAs twice a year, these data do not reflect the full impact of recent falling oil prices on pipeline WACOGs. This decline in oil prices, combined with additional gas-on-gas competition under Commission Order Nos. 380 and 436, is already exerting substantial pressure on pipelines to reduce their WACOGs to marketable levels through out-of-cycle or flexible PGA filings in order to maintain fuel-switchable loads.[228]

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[227] EIA, *Natural Gas Monthly*, *supra* at Table 5 (February 1986).

[228] Pipelines have continued to file for and obtain out-of-cycle or flexible purchased gas adjustments (PGA) authorizations. Listed below are pipelines that have recently obtained a regular PGA at

In addition to PGA data, the Commission has reviewed three studies included or referenced in the record. These three studies all indicate that the most likely impact of the DOE proposal will be further *downward* pressure on consumer prices, as higher old gas prices and additional supplies further accelerate competitive pressures on pipelines and high-cost producers to reduce city-gate prices to market-clearing levels.

The first study, referred to by AGA in its comments, is an "Analysis of High-Cost Gas Purchases by Contract Termination Date."[229] This study (the "Foster Study")

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other than the normal effective date (*), an out-of-cycle PGA (**), or a flexible PGA authorization (***):

Pipeline	*Effective Dates*
ANR Pipeline Co.	8-1-85*, 4-1-86**
Colorado Interstate Gas Co.	5-1-85*, 7-1-85* 9-1-85**, 11-1-85*
Consolidated Gas Supply Corp.	7-1-85*
El Paso Natural Gas Co.	7-1-85*
Florida Gas Transmission Co.	6-1-85*, 2-1-86* 3-1-86**
Mississippi River Transmission Corp.	5-1-85*, 11-1-85*
Natural Gas Pipeline Co. of America	7-1-85*, 1-1-86**
Northern Natural Gas Co.	5-1-85*
Northwest Pipeline Corp.	5-1-85**, 7-1-85*
Panhandle Eastern Pipe Line Co.	6-1-85*
Southern Natural Gas Co.	5-1-85*
Tennessee Gas Pipeline Co.	8-1-85*, 9-1-85** 11-1-85*
Texas Gas Transmission Corp.	12-1-85*, 7-1-85**
Texas Eastern Transmission Corp.	3-1-85*, 7-1-85** 12-1-85**, 4-1-86*
Transcontinental Gas Pipe Line Corp.	4-1-86**
Trunkline Gas Company	3-1-86*
United Gas Pipe Line Co.	11-1-85*
East Tennessee Natural Gas Co.	4-11-86***
Florida Gas Transmission Co.	3-28-86***
Midwestern Gas Transmission Co.	4-11-86***
Northwest Pipeline Corp.	4-25-86***
Tennessee Gas Pipeline Co.	5-2-86***
Transwestern Pipeline Co.	3-28-86***

[229] Foster and Reddick, "Analysis of High Cost Gas Purchases by Contract Termination Date," *Gas Energy Review* (Vol. 13, No. 12, American Gas Association, December 1985).

was prepared by Foster Associates, Inc., on behalf of AGA, and reviewed PGA data as of mid-1985 in order to estimate the volume, producing area, contract execution date, and average price of NGPA section 102 and section 107 gas purchases with projected prices greater than $3.80 per MMBtu. The $3.80/MMBtu price is the Btu-adjusted section 102 ceiling price, and was selected to represent the minimum price under contracts without market-responsive terms.

The Foster Study found that the 1.6 Tcf of gas purchased at an average price of $4.49/MMBtu, or 17 percent of major interstate pipelines' annual domestic purchases of 9.2 Tcf, constituted purchases under pre-1982 section 102 and section 107 contracts with non-market-sensitive terms. In contrast, only 0.7 Tcf of these pre-1982 section 102 and section 107 purchases were found to be market-sensitive, at an average price of $3.12/MMBtu.

Of the 1.6 Tcf in non-market sensitive contracts, 52 percent was found to be produced on the OCS, while Texas and Louisiana on-shore each represented only 10% of the high-cost production.

On the other hand, the Foster Study found only 0.2 Tcf, or 20 percent, of post-1982 section 102 and section 107 contracts were non-market sensitive. The Foster Study found that 13 percent of so-called "high-cost" gas contracts were pre-1977 in vintage, and thus were likely to be "multiple vintage" contracts also covering volumes of old, flowing gas.

This data indicates that some 1.8 Tcf of high-cost gas may not be subject to express "market-out" authority on the part of the purchaser. On the other hand, this 1.8 Tcf represented only 33 percent of all 5.4 Tcf of "new" and "high-cost" gas volumes purchased by interstate pipelines in 1985.[230] The composite price of these total volumes

[230] EIA, *Natural Gas Monthly, supra* at Table 5 (February 1986).

fell from $4.00 per Mcf to $3.37 per Mcf between January 1985 and February 1986.[231] Nor does the Foster Study indicate how much gas under such "non-market responsive contracts" is being "released" from its contract terms and being taken by pipelines at market-responsive prices under the so-called "release" program. This indicates that, notwithstanding their volumes of non-market responsive "new gas," pipelines nonetheless have had sufficient leverage on the rest of their gas costs to reduce overall "new" gas prices over 1 percent a month over the last 14 months—at an overall savings of over $3.4 billion in gas costs.[232]

The second study, submitted by AGA in its initial comments is AGA's "1986 Base Case," an economic model which projects natural gas prices, supply, and demand over the short-term and long-term. The Commission notes that this study ("AGA Base Case") was published January 17, 1986, and, therefore, assumes oil prices of $25/barrel in 1986 and 1987, an assumption that understates the downward pressure of falling oil prices on pipeline WACOGs. AGA's recent up-date on the impact of falling oil prices concludes that under the $15 per barrel scenario, the average field acquisition costs of gas will decline from $2.58 per Mcf in 1985 to $1.37 by 1987. The "1986 Base Case" and its updates are based on a system of computer models providing a long-run simulation of natural gas supply, transportation and markets. This model, known as the TERA (Total Energy Resources Analysis) system, is maintained by the AGA under the guidance of an industry advisory committee. The "1986 Base Case" utilizes publicly available information from contracts on file at the Commission, and is intended to represent a "most probable" future based on current market and regulatory conditions.

[231] *Id.*

[232] Id.

Table 7, following on page 30,244, excerpted from the "AGA Base Case," contains AGA's projection of the average pipeline acquisition cost of gas between 1984 and the year 2000 *under current regulation.* Figures 1, 2, and 4, following on pages 161-3, contain AGA's up-dated projections on reserves, wellhead prices, and demand based on $15 and $20 per barrel oil prices. Specifically, the first table projects that the average pipeline acquisition cost of so-called pre-1982 "high-cost" gas under NGPA section 102, section 103, and section 107 will decline from $3.79/MMBtu in 1984 to $2.69/MMBtu in 1986, and $2.15/MMBtu by 1988. According to the AGA "Base Case," at pages 9, and 12 and 21:

> . . . Between 1985 and 1987, the proportion of 1977-1981 gas at the higher price level is gradually reduced reflecting lengthy renegotiation of the contracts containing "indefinite escalator" clauses. Some post-1977 gas, especially § 102 "d" gas (from OCS Leases) technically remains regulated. The ceiling price, however, is above the level on the . . . The long term "free market surrogate" level of wellhead prices (without severance taxes and gathering charges) for decontrolled natural gas has been arbitrarily assumed to be 50% of the refinery acquisition cost of crude oil . . . As shown on Table 7, the decline of average retail gas prices from $5.08 per MMBtu in 1985 to $4.33 per MMBtu in 1988 represents a 14% [real] decline within 3 years. The decrease from the 1985 retail prices of $5.08 per MMBtu to $4.59 per MMBtu in 2000 represents a cumulative average "real" price drop of about 10%.

TABLE 7.—NATURAL GAS PRICES [1]

(1985$/MMBtu)

	1984	1985	1986	1988	1990	1995	2000
Natural							
Transmsn Co. Acqstn [2]							
Old Inter [3]	1.21	1.14	1.16	1.16	1.15	1.20	1.18
Old Intra [4]	2.42	2.41	2.18	2.10	2.11	2.33	2.57
New-Old [5]	3.79	3.46	2.69	2.15	2.15	2.36	2.59
New-New [6]		2.54	2.27	2.17	2.17	2.37	2.60
Average [7]	2.65	2.53	2.10	1.87	1.90	2.17	2.46
Transmission	1.32	1.26	1.27	1.24	1.26	1.16	1.12
City Gate [8]	3.97	3.79	3.37	3.11	3.16	3.33	3.58
Total Supply:							
Natural [8]	3.97	3.79	3.37	3.11	3.16	3.33	3.58
Supplemental [9]	4.64	3.99	3.62	3.42	3.38	3.70	3.93
Average	4.01	3.82	3.40	3.14	3.19	3.40	3.66
Distribution							
Residential	2.15	2.00	1.93	1.85	1.82	1.60	1.50
Commercial	1.66	1.62	1.58	1.52	1.49	1.31	1.20
Industrial	.55	.64	.62	.58	.56	.47	.43
Elec. Util. P.P.	.34	.19	.37	.43	.38	.50	.47
Average	1.29	1.26	1.24	1.19	1.17	1.01	.93
Retail Price [10]							
Residential	6.16	5.82	5.33	4.99	5.01	5.00	5.16
Commercial	5.67	5.44	4.98	4.66	4.68	4.71	4.86
Industrial	4.56	4.46	4.02	3.72	3.75	3.87	4.09
Elec. Util. P.P.	4.36	4.01	3.77	3.57	3.57	3.90	4.13
Average	5.30	5.08	4.64	4.33	4.36	4.41	4.59

[1] Reflects prices of gas purchased by the natural gas utility industry and sold to customers.

[2] Includes severance taxes and gathering charges.

[3] Includes sections 104a, 104b, 104c, 106a, and 103"e"/108.

[4] Includes sections 105, 106b, and 103"e"/108.

[5] Supplies attached between 1977 and 1982: Includes sections 102, 102d, 103, 107 tight, and 107 deep.

[6] Supplies attached after 1982: Includes sections 102, 103, 107 tight, and 107 deep.

[7] Reflects changing volumetric mix of various supply categories.

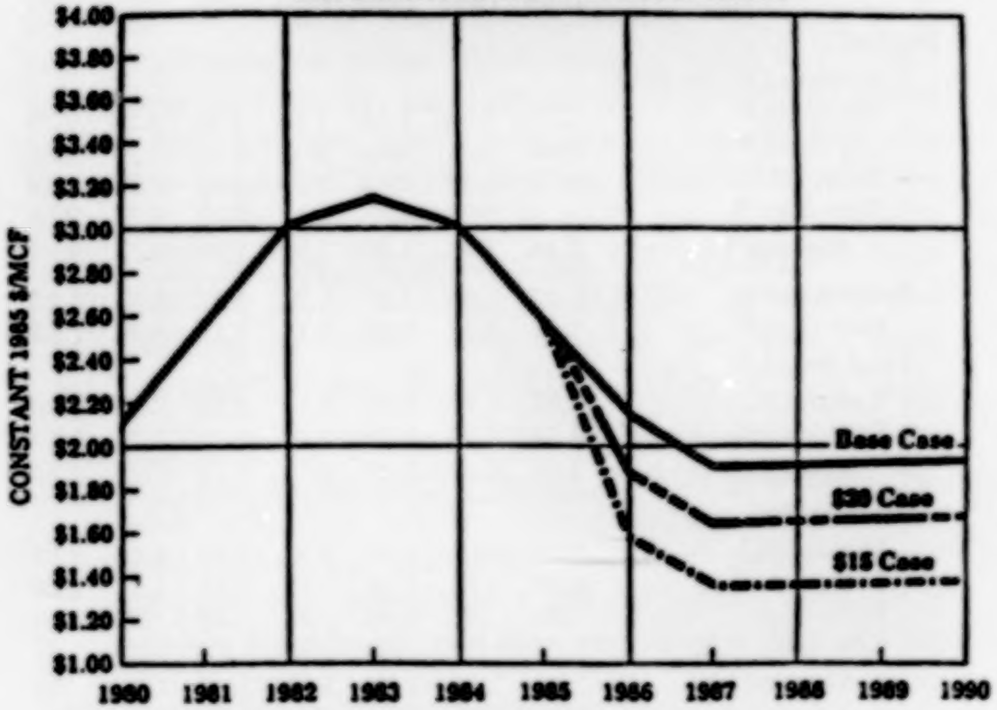
[8] Transmission Company Acquisition Cost plus Transmission Cost.

[9] Includes imports, Alaskan gas, coal gas, gas from new technologies, etc.

[10] City Gate price plus distribution costs.

Figure 1

NATURAL GAS FIELD PRICES UNDER ALTERNATIVE OIL PRICE SCENARIOS*



*Includes inter- and intra-state pipeline acquisitions of gas as well as direct producer-consumer transactions.

Figure 3

U.S. NATURAL GAS CONSUMPTION UNDER ALTERNATIVE OIL PRICE SCENARIOS

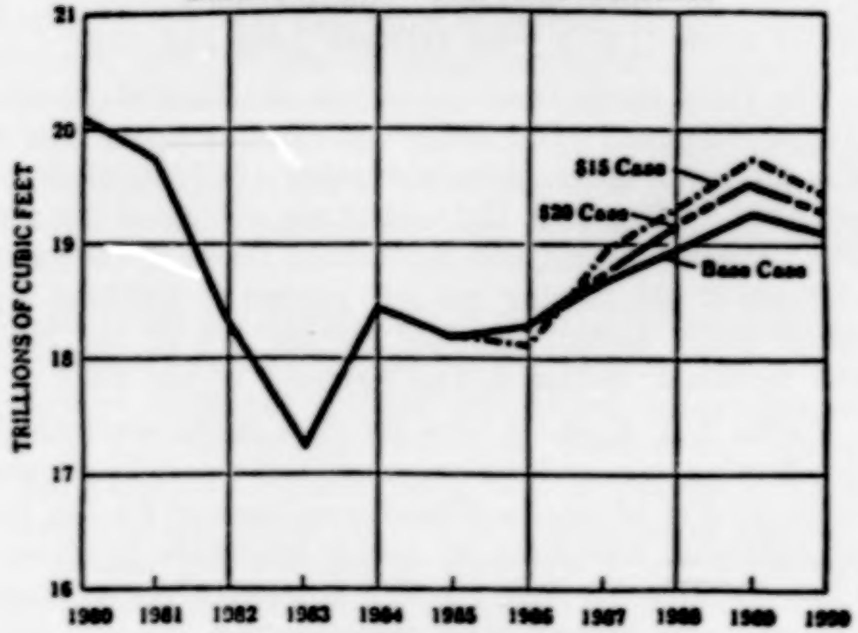
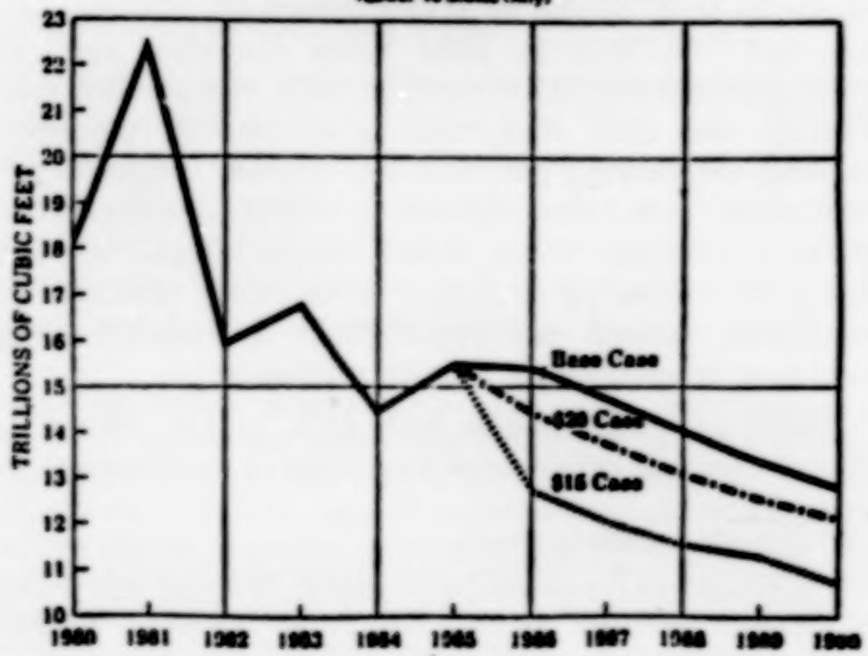


Figure 4

CONVENTIONAL NATURAL GAS RESERVE ADDITIONS UNDER ALTERNATIVE OIL PRICE SCENARIOS

(Lower 48 States Only)



These AGA projections indicate that, even without the pressure of failing oil prices, natural gas markets are expected to force high-cost, "market unresponsive" gas prices down 11% a year between 1984 and 1988.

The third study is an "Analysis of Natural Gas Contracts, Volume I: Old Interstate Gas" prepared by the Energy Information Administration ("EIA") in February 1986.[233] The EIA Old Gas Study evaluated the quantities, average prices, and contractual terms of the various vintages of old, flowing gas still subject to wellhead regulation under section 104 and section 106 of the NGPA and section 4, section 5, and section 7 of the NGA.

Tables 3, 4, 5, and 6 from the EIA study conclude that old, flowing gas under section 104 of the NGPA constituted 3.2 Tcf of total wellhead purchases of 8.4 Tcf from non-affiliated companies by major interstate pipelines in 1984. Of this 3.2 Tcf, 1.1 Tcf is post-1974 gas already subject to the highest MLP under section 104 and priced at an average of $2.49 per MMBtu, while the remaining 2.1 Tcf is priced at $2.12 per MMBtu or below under pre-1974 section 104 vintage prices. The EIA study also concludes that, of the 20 major interstate pipelines, only five had WACOGs in 1984 below the then applicable $2.36 per MMBtu MLP for post-1974 section 104 gas.[234] Finally, the EIA study concludes that 90 percent of existing old, flowing gas contracts contain indefinite price escalators, area rate clauses or other non-market responsive contract terms which could trigger an automatic escalation of contract prices upon wellhead deregulation without any requirement of contract renegotiation or reference to a definite pricing term.

Based on these studies and data in the record, the Commission can make some conservative assumptions concerning the short term trend of new and high-cost gas prices likely under the final rule. If such prices are assumed to continue declining 10 percent a year through 1986 and 1987 (a low estimate compared to AGA's 14 percent per year forecast under $25 oil) then 5.4 Tcf of gas can be expected to decline from an average price of $3.37 in February 1986 to $2.70 per Mcf by January 1, 1988—an overall annual savings in gas cost of $3.63 billion.[235]

On the other hand, 2.01 Tcf of existing old gas volumes are currently priced under NGPA section 104 at an average of $1.61 per MMBtu and below, versus the remaining 1.2 Tcf priced $2.12 per MMBtu and above. We have assumed hypothetically that 90 percent of these volumes will rise to the current average price of the post-1974 section 104 vintage by January 1, 1988—an unrealistically high assumption considering current spot gas prices and the collapse of oil prices. Under this assumption, 1.8 Tcf of old gas currently priced at an overall average of 82 cents per MMBtu would increase to $2.49 per MMBtu by 1988—an overall, hypothetical $3.01 billion in increased old gas costs.

The bottom line under these hypothetical assumptions would be a net *decrease* under the final rule of $620 million in gas costs, an average of 6 cents per MMBtu. However, the Commission considers this a "worst case" scenario because it intentionally *underestimates* the likely dynamic, short-term decline in high-cost gas prices, and *overestimates* the short-term potential increase in old-gas

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[233] EIA Old Gas Study, *supra*.

[234] Colorado Interstate Gas, KN Energy, Natural Gas Pipeline of America, Northern Natural Gas (Now "Enron"), Northwest Central, and Texas Eastern.

[235] All calculations regarding the hypothetical price impacts in this section are derived from Tables 3 and 4 of the EIA Old Gas Study, Table 5 of the EIA February 1986 *Natural Gas Monthly*, and the AGA 1986 Base Case. These calculations also adopt the assumption that 90 percent of existing old gas contracts contain sufficient authorization to enable the seller to collect under the new ceiling price in the final rule without further contract modification other than that expressly required by the rule itself.

prices. This analysis also ignores the further downward pressures of collapsing oil prices, consumer access to alternative gas supplies under Commission Order Nos. 380 and 436, incremental supplies of old gas and the "good faith renegotiation" requirements in the final rule.

For example, the Commission has also considered the assumption in the "AGA 1986 Base Case" that average wellhead gas prices decline 14.3 percent annually from 1985 to 1987, and gas acquisition costs reach an average of $1.87 per MMBtu by 1988. Applying these assumptions to the final rule, new and high-cost gas prices would drop an average of 96 cents per Mcf to $2.41 per Mcf. On the other hand, low-priced vintages of old gas would rise an average of $1.05 per MMBtu to $1.87 per MMBtu. Remaining high-priced vintages of old gas would decline from $2.48 per MMBtu to $1.87 per MMBtu. The resulting hypothetical $1.89 billion increase in low-priced old gas costs would be offset by a combined $5.94 billion decline in new gas and high-priced old gas costs—$5.21 billion from new gas and $730 million from high-priced old gas volumes. The bottom line would be a net *decrease* in overall gas costs under the final rule of $4.05 billion, or 41 cents per MMBtu. Again, however, even this hypothetical projection overestimates any increase in old gas prices under the final rule, because the rule prohibits collection under the higher ceiling price unless the existing purchaser agrees to the new price, or unless the producer is able to negotiate a higher price with another purchaser elsewhere *and* can obtain transportation for the gas.

Although the general trend in pipeline and consumer prices is likely to be stable or downward under the final rule, it is impossible to predict with certainty whether some consumers on some pipeline systems may face short-term, transitional increases in their gas costs before the lower overall prices and enhanced supplies are made available to all pipelines under the rule.

For example, some pipelines may have quicker access in renegotiating high-cost gas prices to lower levels than others, even though the national trend is definitely downward. On the other hand, pipelines with large cushions of old gas may be less able to keep their producers from selling old gas elsewhere to higher bidders, precisely because one goal of this rule is to reduce the disparities in wellhead prices that are not attributable to the actual replacement cost of gas in national markets.

Finally, the Commission is aware that some pipelines may be less confident of their ability to renegotiate all gas prices to more competitive levels with their producers, and expecting the worst, may file for projected purchased gas costs based on the worst possible outcome of their negotiations. In this way, they would, in effect, be passing along the risks of their negotiations directly to their consumers. The Commission intends to scrutinize any such PGA filings very carefully, and will exercise its suspension authority liberally to assure that PGAs track actual gas costs as realistically as possible.

Despite these potential risks, the Commission considers that, under this rule, the overall competitive benefits of more accurate price signals, coupled with the long-term benefits of enhanced supplies of existing gas reserves, will outweigh the risks of any isolated price increases to consumers on individual pipeline systems. It is clear that consumers have suffered shortages and higher prices under the current price system for old gas, and these distortions can only cause more damage to consumers in the future, if existing reserves continue to be sold on a basis less than replacement cost. Keeping old gas rates below replacement cost can only revive shortages and high prices for future generations of consumers.

The final rule is not only intended to balance the interests of present consumers and present producers, it is intended to balance the needs of future consumers for

long-term reliable gas service, with the protection of present consumers from exploitation by producers.

The Commission has chosen to price old gas at its replacement cost, while at the same time requiring producers and pipelines to go through the "good faith negotiation" procedures before collecting any higher prices. This balances the revenue needs of producers to replace reserves with the interests of consumers in assuring that all wellhead prices are subject to the maximum benefits of competition, mandated by the NGPA. The final rule achieves this balance in two ways:

(1) It prevents producers from collecting the higher price for old gas from an existing pipeline purchaser unless the purchaser expressly agrees; and

(2) It allows producers to sell their old gas to anyone in competitive welhead markets under the new price, as long as they first have offered the gas to their existing purchaser and have completed the "good faith negotiation" process in which the purchaser can renegotiate its gas prices with the producer.

The Commission has also reviewed the recent conclusions of the Energy Information Administration (EIA) regarding the likely price impacts of the DOE proposal.[236] EIA independently reviewed the question of whether high-cost contracts are inflexible downward so that removal of controls on low-priced old gas would cause that gas to rise in price without any offsetting downward movement of high-priced gas. The source of data reviewed by EIA was purchased gas adjustment filings of selected interstate pipelines at the Commission during the first half of 1986, separated out by NGPA price category and contract year. EIA concluded:

[236] "An Analysis of the Department of Energy's Notice of Proposed Rulemaking (NOPR), 'Ceiling Prices: Old Gas Pricing Structure'", *Service Report*, Energy Information Administration, May 1986 (RNGD-86-03).

> **A review of new gas contracts indicates that high-priced gas is flexible downward in all NGPA sections and for all vintages . . . Whatever their respective contracts stipulate, the wellhead prices of natural gas can be overwhelmed by market forces and that is precisely what is happening in the market today. Thus, current apprehensions concerning a perceived lack of downward price mobility are unfounded, just as earlier apprehensions about a 1985 gas price fly-up were unfounded.**[237]

The Commission especially notes EIA's conclusions concerning the price flexibility of pre-1982 section 102 new gas contracts, the category considered by pipelines to be the most troublesome. According to EIA's review, "As might be expected, the new vintage Section 102 prices lead the decline, but even the oldest (1978-1981) vintage Section 102 prices exhibited *surprising downward flexibility.*"[238] (emphasis added)

Figures 1-6, 1-7, and 1-8 from the EIA study which graphically represent the trend in high-cost gas contract prices, are not printed in the *Federal Register* but are available from the Federal Energy Regulatory Commission.

The EIA study also reviewed the short-term and long-term price impacts of the DOE proposal, based on $20 per barrel world oil prices and implementation of nondiscriminatory transportation under Order No. 436. EIA based these price impact estimates on a base case forecast of gas markets, in which it is assumed that real world oil prices equal $20 per barrel from 1986 to 1995, supply and demand elasticities (e.g. fuel switching) are consistent with the model used in EIA's *Annual Energy Outlook*, and Order No. 436 is implemented aggressively and generically. In the short-term, EIA concluded,

[237] *Id.* at p. v.

[238] *Id.*

. . . Since most old interstate gas is currently priced below the average U.S. wellhead price, the addition of such gas will put downward pressure on prices . . . It is EIA's judgment that, if implemented generically, Order 436 would create sufficient competition in gas markets to drive the average price down to near the level of the current spot market, a decrease of about \$.30 per Mcf in 1986-1988. Based upon historical experience, this decrease would increase demand by about .25 Tcf per year and thus cause the gas bubble to be drawn down earlier, probably before 1990. The effect of FERC Order 436, coupled with the shrinking of the current gas bubble, is to *keep wellhead prices below \$2.00 per Mcf through 1990.*[239] (emphasis added)

Over the long-term EIA concludes that 28 Tcf of additional gas supplies would be stimulated by the DOE proposal, beginning after the "bubble" of surplus gas deliverability disappears in 1990. If these supplies are produced over a 20-year period, about 1.5 Tcf would reach the market each year. According to EIA, these additional supplies brought on-line under the DOE proposal would keep wellhead prices throughout the 1990s at \$.35 per Mcf lower than the price of natural gas without the additional supplies. By 1995, the average wellhead price of natural gas would be \$2.91 per Mcf under the DOE proposal, compared to \$3.26 per Mcf without the proposal.[240]

EIA's supply enhancement estimates are based on an independent reservoir engineering study it applied to field-specific data available for 557 Texas gas fields under a stipulated wellhead price of \$2.50 per Mcf, in order to estimate the effects of delayed abandonment. EIA also estimated infill drilling recovery, on the basis of a

[239] *Id.* at pp. viii-ix.

[240] *Id.* at pp. 43, 45.

thorough review of a sample of five specific gas fields which already were expected to yield 75 percent of the additional supplies projected for delayed abandonment. Finally, EIA accepted the estimates of other studies as to the potential recovery of 6 Tcf by well stimulation.

The Commission notes that, under \$20 per barrel oil prices and even without Order No. 436, EIA projects that average wellhead prices will decline over 5 percent per year, from \$2.60 per Mcf in 1985 to \$2.07 per Mcf in 1988. When the impact of Order No. 436 is factored in, EIA estimates average wellhead prices will decline nearly 8 percent per year over the short-term, from \$2.60 per Mcf in 1985 to \$1.80 per Mcf in 1988.[241]

For these reasons, the Commission concludes that the final rule will not unreasonably increase consumer gas prices over the short-term, and over the long-term will reduce city-gate gas prices in response to competitive wellhead markets and enhanced recovery of old gas supplies.

F. *Good Faith Negotiation Rule.*

Producers may collect the new ceiling price only to the extent permitted by their contracts. Indefinite price escalation clauses in existing contracts provide the necessary contractual authority.[242] However, the Commission believes that producers with indefinite price escalation clauses should not automatically receive the new ceiling price. Otherwise, the ceiling price would become a floor and that would distort the market as much as current artificially low ceiling prices. Therefore, the Commission will require that parties to existing contracts who do not voluntarily negotiate a new or amended contract price, comply with a "Good Faith Negotiation Rule" before raising the price above current ceiling prices. By allow-

[241] *Id.*

[242] The record indicates that 85 to 90 percent of old gas contracts have indefinite price escalation clauses.

ing each party to assess the value of the old gas in light of competition and other market forces, that rule should prevent old-gas prices from rising above market prices.

The Commission generally adopts the good faith negotiation rule proposed by DOE in its NOPR. However, in order to provide more balanced negotiating rights among the parties, the Commission modifies DOE's proposed rule so that when a producer seeks a higher price for old gas in one contract the purchaser may seek a lower price for all gas (both old and new) in any contract between the parties containing any old gas. This should result in an old gas being priced at the lower of the market or the ceiling price and eliminate the possibility that a purchaser under a multi-vintage contract could be required to continue purchasing the high-cost new gas while the purchaser abandons sales of the low-cost old gas. In addition, this modification should significantly assist in bringing down the price of high-cost gas, including that sold under non-market responsive contracts. The Commission also makes certain other changes in the good faith negotiation rule.

Comments. In the NOPR, DOE proposed that each producer be given a one-time right, exercisable at any time, to request the existing purchaser of old gas under a contract in effect on July 1, 1986, to nominate within 60 days the price the purchaser is willing to pay for the gas. If the existing purchaser refuses to nominate a price, the producer would be free to sell the gas to a new purchaser and would be released from all obligations in law and contract to the existing purchaser upon 30 days written notice that a new purchaser had been found. In the interim, however, the producer would be required to continue to sell the gas to the original purchaser at the existing contract price.

If the purchaser nominates the highest price permitted by the existing contract (in most cases the post-1974 MLP), the producer would be required to sell the gas

to the purchaser at that price. If the purchaser nominates a price less than the highest price permitted by the contract, the producer would have 30 days to indicate whether it accepts or rejects the nominated price. If the producer accepts the nominated price, the producer would be required to sell the gas to the existing purchaser at that price. If the producer rejects the nominated price, the producer would be free to sell the gas to a new purchaser who offered to pay a price higher than the nominated price for a term of at least two years. Once a new purchaser is found, the producer would be released from all obligations in law and contract to the existing purchaser upon 30 days notice. However, in the interim the producer would be required to continue to sell the gas to the existing purchaser at the existing contract price.

Pipeline, distributor and consumer commenters contend that the DOE good faith negotiation rule is illegal and unsound in policy.[243] First, they contend that the

[243] Northwest Central Pipeline Corporation at 13-15, 18-19; Columbia Gas Transmission Corporation at 7; ANR Pipeline Company at 4-5; KN Energy Inc. at 10-11; Kansas Power & Light Company at 14-16; Public Service Commission of West Virginia at 10-11; Transcontinental Gas Pipe Line Corporation, at 5-7; Texas Eastern Transmission Corporation at 23-25; Natural Gas Pipeline Company of America at 14-16, 34-36; Baltimore Gas & Electric Company at 3-4; El Paso Natural Gas Company at 6-10, 16-17; Public Utilities Commission of California at 31-34; Southern California Gas Company at 19-21; Interstate Natural Gas Association of America at 21-24; Tennessee Gas Pipeline Company at 819, 19-23; Peoples Gas Light and Coke Company and North Shore Gas Company at 13-15; Northern Illinois Gas Company at 7; Panhandle Eastern Pipe Line Company and Trunkline Gas Company at 13-16, 25; Southwest Gas Corporation at 6; Minnesota Department of Public Service at 6; Dorchester Hugoton at 7; American Public Gas Association at 62-73; Rochester Gas and Electric Corporation at 25-27; Illinois Commerce Commission at 15-16; Consumer Advocate Division of Public Service Commission of West Virginia at 7-8; E. I. DuPont de Nemours & Company at 14-19; Delhi Gas Pipeline Corporation, reply comments at 2-4; American Gas Association, reply comments at 18-23; People's Gas System

provision of the good faith negotiation rule releasing the producer from all obligations in law to the purchaser if the purchaser fails to nominate an acceptable price grants producers blanket abandonment in violation of NGA section 7(b). Producers sell old gas under certificates of public convenience and necessity issued under section 7(c) of the NGA. Therefore, they may not terminate sales without abandonment authorization from the Commission pursuant to section 7(b) of the NGA. Section 7(b) permits the Commission to grant abandonment only after a hearing and a finding that abandonment is warranted because the available gas supply is depleted or the present or future public convenience or necessity warrant the abandonment. The opposing commenters argue that the good faith negotiation rule would permit abandonment without the necessary hearing or finding that abandonment is in the public interest.

Opposing commenters also contend that the good faith negotiation rule violates the *Mobile-Sierra* doctrine and section 5(a) of the NGA. In *United Gas Pipe Line Co. v. Mobile Gas Corp.*, 350 U.S. 332 (1956), the Supreme Court held that a natural gas company may not unilaterally change its contract. The court further stated that a producer dissatisfied with the existing contract rate may obtain relief only through an NGA section 5(a) proceeding in which the Commission may, after a hearing and based on substantial evidence, determine the existing rate to be unjust and unreasonable. Commenters argue that, contrary to the *Mobile-Sierra* doctrine, the good faith negotiation rule allows a producer unilaterally to abrogate its contract if dissatisfied with the price nominated by the purchaser without the hearing or findings required by section 5(a) of the NGA.

Inc., reply comments at 9-10; United Distribution Companies, reply comments at 47-56; American Gas Association at 3, at 10-11, 27-31; Texas Independent Producers and Royalty Owners Ass'n at 6-7; Northern Natural Gas Company at 3, 5; Northwest Pipeline Corporation at 6-13.

Finally, the opposing commenters argue that the good faith negotiation rule is unduly weighted in favor of producers. By permitting producers who do not get a satisfactory offer from purchasers unilaterally to walk away from their contracts, the rule allegedly would require purchasers to bid the maximum lawful price or face the loss of formerly "low-cost" gas supplies. Commenters contend that as a result the proposed rule's new ceiling price for gas will become the floor.[244] Some opposing commenters also contend that the good faith negotiation rule leads to particularly unfair results with respect to multi-vintage contracts. In such contracts the purchaser may have agreed to a relatively high price for new gas in reliance upon the old gas being priced at or less than current ceiling prices. However, the good faith negotiation rule would permit the producer to seek a higher price for the old gas and, if dissatisfied with the price offered by the purchaser, abandon the sales of the old gas while requiring the purchaser to continue purchasing the high-cost new gas.[245]

Producer commenters and DOE contend that the rule as proposed does not violate NGA section 7 since the requirement of a hearing before granting abandonment is satisfied by the hearing and comment procedure provided in this rulemaking proceeding and automatic abandonment under the good faith negotiation rule is in the public interest. Furthermore, these commenters contend that the good faith negotiation rule does not allow producers unilaterally to change or abrogate contracts where the pipeline refuses to agree to a new higher contract price desired by the producers. Instead, there would be a bilateral agreement not to continue under the existing contract and its existing authority to collect the higher ceiling price without renegotiation. Therefore, there is no

[244] *See*, for example, INGAA at 22-24.

[245] *See Northwest Pipeline Corporation* at 10-11.

violation of the *Mobile-Sierra* doctrine. Finally, these commenters contend that the good faith negotiation rule is not duly weighted in favor of the producer but provides for balanced negotiation.

In their comments supporting the DOE proposal, Indicated Producers present a modified good faith negotiation procedure designed to avoid the legal challenges raised by parties opposing the DOE rule. Under this proposal, the Commission would impose a moratorium on rate increase filings for old gas subject to the new ceiling price until one of three conditions is met. The first condition would be that the producer files a new or amended contract together with a petition requesting authorization to collect the applicable contract rate, up to the new maximum lawful price. The second condition would be that the producer files for collection of the applicable contract rate, up to the new maximum lawful price, together with an agreement by the purchaser that the moratorium be lifted. The third condition would be that the producer files an application for abandonment of the sale of the gas and tenders to the purchaser a release from the contract for the gas which is the subject of the abandonment application. If this is done, the producer could simultaneously file for collection of the applicable contract rate agreed to by a third party, up to the new maximum lawful price, and would be entitled to collect this rate from the original purchaser until abandonment is granted. The pipeline and its customers could either contest the abandonment application or support it and accept the release offered by the producer.

Indicated Producers argue that the modified proposal will give pipelines as well as producers compelling economic incentives to renegotiate their contracts in order to provide for market-responsive old-gas prices while avoiding possible legal infirmities in the good faith negotiation rule proposed by DOE. The Natural Gas Supply Association (NGSA) supports Indicated Producers' proposed modification of the good faith negotiation rule.

Commission Response. The Commission rejects opposing commenters' contentions that the grant of abandonment to a producer if the purchaser fails to nominate a price or mominates an unacceptable price violates NGA section 7(b). The Commission finds, based on the present record, that the present and future public convenience or necessity permit abandonment in such circumstances. Granting abandonment where the existing purchaser fails to make an acceptable offer is in the interest of the market as a whole.[246] This abandonment is necessary to ensure that all old gas, with its relatively low production cost, can obtain the market-responsive prices permitted by this rule. Without the possibility of abandonment, the purchaser could simply insist on a continuation of the present price. Only through such higher prices will increased production through delayed abandonment occur, as described in section I VD, *supra*. The resulting increased supply of old gas will displace higher-cost gas, create more competition in the market place, and thus bring down overall prices as described in Section IV E, *supra*.

The Commission also finds without merit the opposing commenters' contention that the good faith negotiation rule's provision for abandonment violates NGA section 7(b)'s hearing requirement. That hearing requirement is satisfied by the hearing and opportunities to comment provided in the present rulemaking. Section 7(b) does not require that the Commission hold individual case-by-case hearings.[247] The Commission has determined in this

[246] In *Felmont Oil Corp. and Essex Offshore Inc.*, 33 FERC ¶ 61,333, at p. 61,657 (1985), the Commission announced a change in its abandonment policy, stating that there would be "a shift in the identification of the public interest, from the interest of only specific customers to the interests of the market as a whole."

[247] *See Phillips Petroleum Co. v. FPC.*, 475 F.2d 842, 848-852 (10th Cir. 1973), and *American Public Gas Ass'n. v. FPC*, 567 F.2d 1016, 1064-1067 (D.C. Cir. 1977), holding that the Commission may establish area and national rates in rulemaking pro-

proceeding that the public interest permits abandonment of old gas wells in cases where a purchaser fails to nominate an acceptable price. Therefore, it would make no sense for the Commission to require individual producers to file abandonment applications and to hold a hearing on each application. Since there are thousands of producers of old gas, that procedure could result in a vast proliferation of hearings. Given the Commission's limited resources, the inevitable result would be lengthy delays before individual abandonments could be granted. This would seriously impede the achievement of this rule's goals of increasing production of old gas and reducing overall prices. As the Supreme Court said in *Texaco v. FPC*, "We see no reason why under this statutory scheme the processes of regulation need be so prolonged and crippled."[248] Accordingly, the Commission holds that where the purchaser fails to nominate a price, or nominates a price which the producer rejects, the producer is granted abandonment upon 30 days notice.[249]

Second, the Commission rejects the opposing commentters' contention that the good faith negotiation rule permits producers unilaterally to change or abrogate con-

ceedings as opposed to case-by-case adjudications without violating the similar hearing requirements of NGA sections 4 and 5. *See also*, *FPC. v. Moss*, 424 U.S. 494, 500-501 (1976), stating that the Commission has discretion to determine the timing of its finding that the public convenience or necessity permit abandonment, including the discretion to pre-grant abandonment on a generic basis even though years may elapse before the abandonment actually occurs.

[248] 377 U.S. at 33, 44 (1964). *See also*, *Phillips Petroleum Co. v. FPC*, 475 F.2d at 849, 851, citing *Permian*, 390 U.S. at 777, holding that the Commission has broad discretion to contrive expeditious administrative methods in order to achieve its regulatory purposes.

[249] As explained in more detail later, *infra* at pages 196-199, the abandonment will be limited to the old gas wells for which the producer sought a higher price.

tracts in violation of the *Mobile-Sierra* doctrine and section 5(a) of the NGA. This contention is based on a misunderstanding of how the good faith negotiation rule works. As DOE and supporting commenters observe, the producer cannot alter the contract in any way under the good faith negotiation rule. It can obtain a higher price only if the existing contract already provides for such higher price through an indefinite price escalation clause. Furthermore, the purchaser has an absolute right to continue the existing contract if it is willing to pay the highest price permitted in that contract. However, as a condition to obtaining a higher price under the contract, the producer must give the purchaser an opportunity to seek a lower price under that contract and certain other contracts, or terminate the contracts if it is unwilling to pay the contract price or such lower price as the producer is willing to accept. The producer is required to give the purchaser this right in order to prevent indefinite price escalation clauses in existing contracts from automatically raising the price to the new ceiling price. In the case of other old gas for which the purchaser affirmatively requests a lower price or other categories of gas under a multi-vintage contract containing old gas, again, the pipeline, not the producer, is initiating the renegotiation process, and only as a condition precedent to the producer being authorized to collect a higher price under an existing contract pursuant to an indefinite escalation clause. Thus, only the purchaser, not the producer, has a right to terminate the contract, and the purchaser has that right only because the producer has chosen to give it to him. There is, therefore, no violation of the *Mobile-Sierra* doctrine. To the extent the Commission must, pursuant to NGA section 5, hold a hearing and find that the existing rate is unjust and unreasonable before the producer can obtain a rate higher than the present rate, the Commission has in the present proceeding already made such a finding after a hearing. *See* Section IV B, *supra*.

The Commission generally disagrees with the opposing commenters' contention that the good faith negotiation rule, as proposed, is unfairly weighted in favor of producers and would result in pre-1975 gas escalating to the new price ceiling while no other gas would come down in price. As explained in Section IV E, the Commission believes that competitive forces in the natural gas market, including competition from alternative fuels, would prevent this from happening. However, the Commission does agree that the rule as proposed could be unbalanced in two respects. First, the rule provides only for the renegotiation of old gas contracts with below-market prices and does not permit purchasers to obtain the renegotiation of old gas contracts with above-market prices. For example, if a producer and purchaser had two contracts, one covering primarily pre-1973 flowing gas and the other covering primarily post-1974 gas, the producer could seek a higher price only for the first contract. There would be no way for the purchaser to seek a lower price for the post-1974 old gas in the second contract under the good faith negotiation rule even though the post-1974 ceiling price may be above the current market price for gas.

Second, the Commission agrees with the contentions of opposing commenters that the good faith negotiation rule, as proposed, could be unbalanced in its treatment of multi-vintage contracts. For example, if a contract included both old and other gas, the producer could seek a higher price for the old gas but the purchaser could not seek a lower price for the other gas. If the producer was not satisfied with the price nominated by the purchaser for the old gas, the producer could terminate sales of the old gas to the purchaser, sell that gas to a third party, but require the purchaser to continue purchasing the other gas. Yet the purchaser may have agreed to the high price for the other gas in reliance on the fact the low cost of the old gas lowered the average price under the contract to reasonable levels.

In order to cure these inequities in the operation of the good faith negotiation rule as proposed and to assure that purchasers will have the ability to substantially reduce their cost of purchasing high-cost gas, the Commission will modify the good faith negotiation rule as follows. If a producer makes a nomination request with respect to old gas in one contract, the Commission will permit the purchaser to seek a lower price for any gas, whether old or new, in any contract between the parties which contains some old gas. In the event the producer and purchaser cannot agree on a new price for the gas for which the purchaser made a nomination request, the purchaser shall have the right to terminate its purchases of that gas under the contract in question.[350] If the purchaser exercises this right with respect to gas subject to the Commission's NGA jurisdiction, the Commission will also permit abandonment. The public convenience and necessity permits that abandonment for the same reasons discussed above with respect to the producer's abandonment of sales of below-market old gas and because the

[350] This would, of course, include a right for the purchaser to terminate purchases of some gas removed from the Commission's NGA jurisdiction. *Pennzoil Co. v. FERC*, 645 F.2d 360 (5th Cir. 1981), *cert. denied*, 454 U.S. 1142 (1982), holding that the Commission can no longer interpret contracts that cover gas removed from the Commission's NGA jurisdiction, does not prevent the Commission from requiring that producers provide purchasers this opportunity under the good faith negotiation rule. The Commission is acting pursuant to its authority under NGPA sections 104(b)(2), 106(c), and 501(a) to condition the producer's eligibility to obtain a higher price for jurisdictional old gas under the good faith negotiation rule on its giving the purchaser an opportunity to renegotiate all gas under multi-vintage contracts containing any old gas. *Shell Oil co. v. FPC*, 520 F.2d 1061, 1077 (5th Cir. 1975), supports the Commission's authority to condition collection of a new just and reasonable ceiling price under NGPA sections 104 and 106 on a contractual *quid pro quo*. *See also*, *Pennzoil Co. v. FERC*, 671 F.2d 119, 127 (5th Cir. 1982), holding that the Commission may place such condictions on eligibility for ceiling price as are "reasonably calculated to further [the Commission's] legitimate regulatory policy."

purchaser is no longer taking the gas. Permitting the purchaser to seek a lower price for all gas in any contract containing any old gas will enable purchasers to bring down the cost of all above-market old gas and the cost of any other above-market gas in multi-vintage contracts. This should substantially reinforce the purchaser's ability to reduce its cost of purchasing high-cost gas, including that sold under non-market responsive contracts.[251]

The Commission also modifies the good faith negotiation rule so as to eliminate the requirement that any contract the producer enters into with a third party after rejecting the price nomination by the purchaser be for a higher price and a term of at least two years. The Commission believes that these requirements would be contrary to the goal of making natural gas contracts more market-responsive. The two-year requirement effectively prohibits market-out clauses for a period of two years. Most new contracts contain such clauses and such clauses have been instrumental in permitting pipelines to reduce their purchased gas costs in recent years. Also, both the two-year and higher price requirements seem unfair and unnecessary in light of the increased bargaining rights the Commission has given the purchaser with respect to above-market old gas and to other gas in multi-vintage contracts. Finally, the higher price requirement is also unnecessary since it is extremely unlikely the seller would sell gas for less than the price it could obtain from the original purchaser. Furthermore, the final rule provides

[251] *See* the more detailed discussion of this matter, *supra* at 149-150.

The Commission will also deem any pipeline which has not accepted Order No. 436 to have agreed to transport gas whose sale has been abandoned or released by either the producer or the pipeline under the good faith negotiation rule to any existing customer of the pipeline or another pipeline interconnected with the first pipeline. This matter is discussed in more detail in section VI D.

the firm sales customers of the original purchaser with a right of first refusal of any offer to sell the gas to a new purchaser.

For the reasons described above, the Commission believes that the good faith negotiation rule, as modified, provides for balanced negotiation between the parties. In addition, the Commission finds unconvincing the contention of opposing commenters that the good faith negotiation rule would require purchasers to nominate the new ceiling price for old gas since otherwise they would risk loss of that gas. The good faith negotiation rule is designed to benefit purchasers by giving them a right, not generally provided by their contracts, to seek a price lower than that which the contracts would otherwise require them to pay. Any assertion that this right is illusory overlooks the substantial incentive producers have to reach an agreement with the existing purchaser. The producer is unlikely to sell to another purchaser unless it finds one willing to offer a better bargain than the existing purchaser. In today's market that may be difficult. Until the producer commences sales to an alternative purchaser, it must continue sales to the original purchaser at the old low prices. Also, the purchaser's right under the modified good faith negotiation rule to terminate purchases of above market gas, whether old or new, in any contract containing any old gas gives the purchaser an additional strong bargaining card in any negotiation with the producer. In light of these pressures on the producer to negotiate in good faith, it is unreasonable to believe that, in today's competitive market, pipelines will feel constrained to nominate the ceiling price in order to avoid loss of old gas. The fact that pipelines are currently marketing out on all categories of gas at prices less than the post-1974 ceiling price (see table 2 at page 143) further supports the Commission's belief that pipelines will not automatically nominate the ceiling price.

Some commenters contend that a pipeline's sales customers may be harmed when old gas sales to that pipeline are abandoned under this rule. The pipeline's customers may have relied on the pipeline's continued access to that gas, pursuant to the producer's NGA service obligation, as insuring that they had access to an adequate supply of gas at reasonable prices. The commenters contend that the pipeline's loss of the gas may increase the pipeline's system supply sales costs, thereby harming the pipeline's firm customers.[252] The Commission believes that generally a pipeline's customers will not suffer higher prices under this rule. As explained in Section IV E, *supra*, the Commission believes that competitive pressures, including competition from alternative fuels, will create strong pressures on pipelines to take such actions as are necessary to keep their WACOGs down in order to avoid loss of market.

However, in order to afford additional protection to the pipeline's customers, the Commission makes a further modification in the good faith negotiation rule. The Commission will require that, whenever gas is released under this rule and the existing purchaser is not an Order No. 436 transporter, the producer may not sell gas subject to the Commission's NGA jurisdiction to anyone other than the pipeline's firm sales customers until it has given those customers a right of first refusal. If the seller makes an offer to a third party encompassing non-jurisdictional, as well as jurisdictional gas, the right of first refusal will apply to the entire offer. The right of first refusal would give the firm sales customers an opportunity to purchase the gas under the identical terms agreed to between the producer and the third party. If more than one firm sales customer accepts the third

[252] In particular, some commenters fear that off-system purchasers, such as large industrial users, could outbid the pipeline for the gas since they generally do not have the take-or-pay obligations for new gas that many pipelines have and that this would cause the pipeline's system supply sales cost to rise.

party offer, the producer may at its discretion choose which firm sales customer it will sell the gas to. The pipeline is deemed to agree to transport the gas to the firm sales customers.[253] There is no need to provide the firm sales customers a right of first refusal when their pipeline is an Order No. 436 transporter, since the customers of an Order No. 436 pipeline could purchase gas from any producer connected to that pipeline and have the gas transported to them.

This procedure should enable firm sales customers to purchase any gas abandoned under this rule at a price approximately equal to or less than the pipeline's WACOG.[254] Thus, the firm sales customer's access to adequate supply at reasonable cost is protected.

Finally, the Commission alters the good faith negotiation rule as proposed in one other respect. The Commission provides that no producer may request a purchaser to nominate a price under the good faith negotiation rule until November 1, 1986. This will allow the parties an opportunity to voluntarily renegotiate their contracts before negotiations begin pursuant to the good faith negotiation rule. It will also provide all affected parties an opportunity to familiarize themselves with the operation of the rule.[255]

The following is a summary of the operation of the good faith negotiation rule, as modified. The Commission will illustrate the summary by reference to the following

[253] *See* Section VI D.

[254] The firm sales customer will probably pay more for any abandoned gas than the pipeline paid for that particular gas, but this does not mean the customer will be paying more than it previously paid the pipeline for a comparable amount of gas since the price the customer paid the pipeline represented the rolled-in cost of all the pipeline's gas.

[255] *See* petitions of AGA, AGD, INGAA, and UDC filed May 23, 1986.

example. A producer and purchasers have two contracts. Contract A and Contract B, both existing on the effective date of this rule and both with indefinite price escalation clauses permitting the producer to collect the highest price allowed by law. Each contract provides for the sale of gas from pre-1973 flowing gas wells, post-1974 old gas wells, and new gas wells. However, most of the gas sold under Contract A is pre-1973 flowing gas while most of the gas sold under Contract B is post-1974 old gas and new gas. The good faith negotiation process is initiated by a producer requesting in writing that a purchaser of old gas under a contract or service obligation existing on the effective date of this rule nominate a new price[256] for the old gas. Of course, there must be contractual authority for a higher price, for example through an indefinite price escalation clause. The producer may make a request at any time after October 31, 1986, but no more than once with respect to any particular contract. The producer may also specify the particular old gas wells for which it desires the purchaser to nominate a price.

Thus, in the Commission example, since both contracts existed on July 18, 1986, and contain indefinite price escalation clauses, the producer may request the purchaser to nominate a new price for the old gas in either or both contracts.[257] Therefore, the producer might well

[256] Obviously, the producer's goal would be to obtain a higher price. However, nothing in the rule prevents a purchaser from nominating either the same price currently being paid or a lower price.

[257] The Commission has assumed both contracts existed on July 18, 1986. If one had expired on June 1, 1986 but sales were continuing pursuant to a service obligation, the producer could still make a nomination request so long as the expired contract contained an indefinite price escalation clause. However, if one of the contracts was not entered into until August 1, 1986 that contract could not be renegotiated under the good faith negotiation rule. The contract is considered entered into as of the date it is

choose, initially at least, to make a request only with respect to Contract A since most of the gas covered by Contract B is already at above-market prices. The producer might also specify that the purchaser nominate a new price only for the pre-1973 flowing gas wells in Contract A. Assuming the producer does this, however, it may not subsequently request the purchaser to nominate a price for the post-1974 old gas under Contract A.[258] However, since Contract B has not yet been placed on the negotiating table, nothing would prevent the producer from making a subsequent nomination request with respect to old gas under that contract. For convenience, the Commission will refer to the producer's initial nomination request as "step 1" in the nomination request process under the good faith negotiation rule.

Within thirty days of the producer's request in step 1, the purchaser may request in writing that the producer

executed. The Commission also assumed in the example that both contracts contained indefinite price escalation clauses. There could be more complicated situations. For example, a contract might have an indefinite price escalation clause and cover 1973-1974 Biennium gas. However, the parties may have executed an amendment providing that the gas be sold at a fixed price less than the 1973-1974 Biennium ceiling price for the period May 1, 1986 to April 30, 1987. In this case, the producer may at any time after October 31, 1986 request the purchaser to nominate a new price for the 1973-1974 Biennium gas but such price would only apply starting May 1, 1987 since there is no contractual authority for a higher price before then.

[258] In the Commission's example, the producer has lost nothing by not making a nomination request with respect to the post-1974 gas in Contract A since that gas is already priced at the new ceiling price. However, if the contract had included 1973-1974 Biennium gas and the producer made no nomination request with respect to that gas, the producer would have lost the right to negotiate a higher price for that gas under the good faith negotiation rule. Accordingly, if a producer believes that it could not in present market conditions obtain a higher price for 1973-1974 Biennium gas, as an example, it may wish to postpone making any nomination request with respect to the contract until a later date when it believes market conditions are more favorable.

nominate a new price[259] for any old or other gas sold under the contract covered by the producer's request. In addition, the purchaser may request that the producer nominate a new price for any gas sold under any other contract between the parties which contains some old gas. As is the case with the producer, the purchaser may specify the particular wells both in the contract covered by the producer's original request and in the other old gas contracts for which it desires the producer to nominate a price, but may not subsequently request that the producer nominate a new price for any wells in either contract for which it does not request the producer to nominate a price. Also, the purchaser may include in its request the same old gas wells covered by the producer's request. This constitutes step 2 in the nominating request process under the good faith negotiation rule.

Accordingly, in the Commission's example, where the producer had requested that the purchaser nominate a new price only for the pre-1973 flowing gas in Contract A, the purchaser could request that the producer nominate a new price[260] for any gas in Contract A.[261] In

[259] The producer is free to nominate a higher price than is currently being paid to the extent applicable ceiling prices would not be violated and the contract permits it.

[260] Presumably, the only old gas in those contracts the purchaser would request that the producer nominate a new price for would be the post-1974 old gas and new gas since that is the only gas it could reasonably expect to obtain a lower price for.

[261] If the purchaser believes that some of the gas for which the producer requested it to nominate a price is overpriced, the purchaser may want to request that the producer nominate a price for the same gas. This is because, even if the producer nominated a lower price in response to the producer's request, the producer could reject the nominated price but not terminate sales. In this event, the purchaser would be required to continue purchases at the existing price unless it had requested that the producer nominate a price and rejected the price nominated by the producer. In the latter circumstance, the purchaser could terminate its purchases. Such a situation is perhaps most likely to

addition, since Contract B contains old gas, the purchaser could request that the producer nominate a new price for any gas in that contract. If, however, Contract B had contained only new gas, the purchaser could not request that the producer nominate a new price for the gas in that contract.

Within thirty days of the purchaser's request that the producer nominate a new price for any gas in contracts not included in the producer's original request, the producer may request in writing that the purchaser nominate a new price for any old gas in those contracts. This is identified as step 3 of the nominating request procedure. Thus, if in the Commission's example the purchaser requested that the producer nominate a new price for the post-1974 old gas and the new gas in Contract B, the producer could request that the purchaser nominate a new price for the pre-1973 flowing gas in Contract B. If the producer failed to request that the purchaser nominate a price for pre-1973 flowing gas in Contract B, it could not subsequently make such a request since that contract is now on the negotiating table and a contract may be renegotiated only once under the good faith negotiation rule.

A request by a producer that the purchaser nominate a new price in either step 1 or step 3 will initiate the following procedures. The purchaser will have sixty days from the producer's request to nominate in writing the price it is willing to pay. If the purchaser nominates the highest price permitted by the existing contract (in most cases the post-1974 MLP), the producer would be required to sell the gas to the purchaser at that price under the existing contract. If the purchaser nominates a price less than the highest price permitted by the contract, the producer would have 30 days to indicate whether it accepts or rejects the nominated price. If the

occur with respect to 1973-1974 Biennium gas, which is not included in the Commission's examples.

producer accepts the nominated price, the producer would be required to sell the gas to the existing purchaser at that price under the existing contract. If the producer rejects the nominated price, the producer would be free to sell all the gas to a new purchaser subject to a right of first refusal on the part of the existing firm customers of the existing purchaser. There would be no required term for the new contract, nor any higher price requirement. Once a new purchaser is found, the producer would be released from all obligations in law and contract to the existing purchaser upon 30 days notice. However, in the interim, the producer would be required to continue to sell the gas to the existing purchaser at the existing contract price. If the purchaser failed to nominate a price in writing, the producer's rights would be the same as when it rejected the purchaser's offer.

The operation of these procedures may be illustrated using the Commission's example described above. If in step 1 the producer requested that the purchaser nominate a new price for the pre-1973 flowing gas in Contract A and the purchaser either failed to nominate a price or the producer rejected the nominated price,[262] the producer would be free to sell the pre-1973 flowing gas to another party subject to the right of first refusal of the existing purchaser's firm customers. If the producer found a purchaser for part or all of that gas, the producer could abandon the sales of the gas to be sold to the other purchaser upon 30 days notice.[263] Contract A would, how-

[262] The producer must either accept or reject the purchaser's nomination in its entirety. The producer may not accept the nominated price for half the pre-1973 flowing gas wells but reject the nominated price for the other half. A partial acceptance is the equivalent of complete rejection. Sales continue for all the wells at the existing price, but the producer may abandon the sales upon 30 days notice.

[263] The producer need not abandon all the pre-1973 flowing gas. If it finds a new purchaser willing to pay a higher price for some of the gas, it may abandon the sales of just that gas and continue

ever, remain in effect with respect to all other gas subject, however, to further alteration as a result of any nomination requests made with respect to that contract in other steps of the nominating request procedure.

A request by a purchaser that a producer nominate a new price in step 2 will initiate the following procedures. The producer will have 60 days from the purchaser's request to nominate in writing the price it is willing to accept. The purchaser will have 30 days thereafter to indicate whether it accepts or rejects the nominated price. If the purchaser accepts the nominated price, it will continue purchasing the gas at that price under the existing contracts; if the purchaser rejects the nominated price, it shall be permitted at any time thereafter, upon 30 days written notice to the producer, to discontinue purchases from the wells subject to the nomination request. Pending expiration of the 30 day notice period, the purchaser shall be required to continue its purchases at the existing price under the contract. Once purchases are discontinued, the sales of the gas will be deemed abandoned and the producer will be free to sell the gas to another purchaser.

Accordingly, in the Commission's example, if in step 2 the purchaser requests that the producer nominate a new price for the post-1974 old gas and the new gas in Contracts A and B and rejects the price nominated by the producer for each contract,[264] it may discontinue pur-

selling the other pre-1973 flowing gas to the original purchaser at the original price.

[264] The purchaser must accept or reject the producer's offer with respect to gas in one contract in its entirety. Thus, the purchaser could not accept the producer's offer for the post-1974 gas in Contract A but reject the offer for the new gas in that contract. Any attempt to do so would amount to total rejection. The purchaser would continue purchasing all the gas at the existing price subject to its right to terminate all or part of the purchases upon 30-days notice. However, the purchaser could reject the price nominated

chases from some or all of the post-1974 and new gas wells at its discretion upon 30 days notice. Both contracts remain in effect, however, with respect to all other gas, subject to further alteration resulting from other nomination requests made under the good faith negotiation rule.

Whenever any gas previously sold to a pipeline which has not accepted Order No. 436 is abandoned under this rule, the producer must give the pipeline's firm sales customers a right of first refusal before selling jurisdictional gas (or any other gas included in an offer to a third party for the sale of jurisdictional gas) to anyone else. Existing firm sales customers are those as of the date the third party accepts the first seller's offer. The procedures governing the right of first refusal generally track those set forth in 18 CFR § 277.206 governing the right of first refusal which NGPA section 315 requires that seller give existing purchasers of gas removed from the Commission's NGA jurisdiction by the NGPA. Significant differences include (1) that the pipeline must inform the producer of the names and addresses of its firm customers so as to enable the producer to send the third party offer to the firm customers and (2) that the producer has discretion to determine which firm customer to which to sell the gas when more than one accepts the third party offer. If the firm customers reject the third party offer and the producer sells the gas to the third party, no further right of first refusal will arise when the contract with the third party expires or is renegotiated.

A pipline purchaser which has not accepted Order No. 436 is deemed to agree to transport on behalf of any shipper any gas released under this rule to an existing customer of the pipeline or to any pipeline interconnected with the releasing pipeline.

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by the producer for Contract A but accept the nominated price for Contract B.

Finally, the parties to any contract shall be free by mutual agreement at any time prior to abandonment under the terms of this rule to extend any deadline for action by either party under the rule and to maintain the status quo during the period of extension. In addition, the parties may, of course, renegotiate a contract at any time without using the good faith negotiation procedures except that such renegotiation of any contract will prevent any subsequent renegotiation of that contract under the good faith negotiation rule.

The Commission recognizes the complexity of the operation of the good faith negotiation rule. However, the complexity of the rule is necessary to provide balanced negotiating rights for both producers and purchasers. The Commission believes that the rule can be applied efficiently, however. The Commission expects that, before invoking the formal procedures of the good faith negotiation rule, the parties will informally consult with one another in an effort to voluntarily renegotiate their contracts. If the parties reach agreement, the good faith negotiation procedures would never be invoked. The parties would simply amend their contract, thereby removing that contract from the application of the good faith negotiation procedure in the future for purposes of this rule.[265] Accordingly, the Commission expects that the formal procedures of the good faith negotiation rule will be invoked only if the parties are unable to reach agreement and one or the other desires termination of some or all sales under a contract.

V. Adoption of the Old Gas Proposal

A. *Ceiling Price and Procedures.*

Sections 271.402 and 271.602 of the Commission's regulations are amended to incorporate the NGPA section

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[265] Neither party may invoke the good faith negotiation rule with respect to a contract after that contract has been voluntarily amended after July 18, 1986.

104 post-1974 price as an alternative ceiling price for gas subject to maximum lawful prices under NGPA sections 104 and 106, effective [insert date 30 days after publication in the *Federal Register*]. Producers may collect any price up to the alternative ceiling price based on mutual agreement with their purchasers. The new ceiling price will also be available to producers in cases where the seller and purchaser renegotiate the terms of their existing contract and thus enter into a new contract. There will be no change in applicable Commission rate filing requirements.[266] However, those filing requirements are waived for sales of gas abandoned under the good faith negotiation rule and resold under a blanket certificate.

A new § 270.201 of the Commission's regulations will also be adopted incorporating the good faith renegotiation procedures established by this rule.

B. *Applicability.*

The new alternative ceiling price will be available subject to the terms of this order for any and all sales of gas which would be, absent this rule, subject to existing lawful prices under sections 104 and 106 of the NGPA.

C. *Affiliate Purchases and Pipeline Production.*

Under the NGPA, producers affiliated with interstate pipelines are entitled to applicable NGPA ceiling prices. Under the Supreme Court's decision in *Public Service Commission of New York v. Mid-Louisiana Gas Company*,[267] pipelines are also entitled to NGPA maximum lawful prices for gas which they produce and take into their own system.[268] In both cases, recovery of maximum lawful prices by interstate pipelines is subject to the "affiliated entities" test set forth in section 601(b)(1)(E) of the NGPA. That section provides that the amount paid is deemed just and reasonable if it does not exceed the amount paid in comparable first sales between persons not affiliated with the interstate pipeline. Consistent with existing Commission policy, affiliate and pipeline production will be eligible for the alternative ceiling price established by this rule, subject to the requirements of the affiliated entities test.

D. *Minimum Rate and Fixed Price Gas.*

Minimum rate gas is sold under a contract that provides for a price lower than the minimum rate ($.32 per Mcf in April 1986) and which is thus entitled to the minimum rate as a result of the incorporation by the NGPA of the minimum rate provisions of Commission Opinion No. 749.[269] Fixed price gas is sold under a contract that provides for a fixed price greater than the minimum rate but less than the applicable maximum lawful price. Neither minimum rate nor fixed price contracts provide for automatic escalation to applicable maximum lawful prices.

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[266] Pursuant to sections 154.91-154.94 of the Commission's regulations, large producers are required to maintain their contracts for jurisdictional sales of natural gas on file with the Commission as rate schedules and to file with the Commission notices of any change in rate together with the contractual authority for the change. Section 154.94(h) provides that rate changes that merely reflect application of the monthly inflation adjustment factor can be made on the basis of a blanket affidavit without making rate change filings each month. Section 157.40 provides that small producers, i.e., not affiliated with a major pipeline company and with jurisdictional sales of less than 10,000,000 Mcf of natural gas per year, are exempted from the rate filing requirements described above for sales under their small producer certificates.

[267] 463 U.S. 319 (1983).

[268] The Commission implemented the Mid-Louisiana decision in Order Nos. 391, 49 FR 33849 (Aug. 27, 1984) and 391-A, 50 FR 14374 (Apr. 12, 1985); 18 CFR 270.203 (1985).

[269] 54 FPC 3090 (1975).

The ability of producers under this rule to negotiate increased prices, with recourse to abandonment if agreement is not reached, is predicated on the existence of contractual authority to receive the new ceiling price. Since producers selling gas at the minimum rate or a fixed price below the applicable NGPA ceiling price do not have the required contractual authority, this rule will not provide for automatic abandonment when the purchaser refuses to agree to price increases in such cases. The Commission intends that producers with such contracts be eligible for the new ceiling price, but absent the purchaser's agreement, they must continue selling under their existing contractual arrangements. Accordingly, sellers of minimum rate or fixed price gas will be eligible for the alternative ceiling price only if and to the extent their purchasers agree.

E. *NGPA Section 106(b) Gas—Intrastate Rollover Contracts.*

Pursuant to NGPA section 121(a)(3), most gas sold in intrastate commerce was price deregulated as of January 1, 1985. One of the categories not deregulated is intrastate rollover gas selling under section 106(b) for $1.00 per MMBtu or less on December 31, 1984. Several commenters have suggested that producers of section 106(b) gas subject to continued regulation should be eligible for the new alternative ceiling price.[270]

The Commission perceives no reason why gas sold under section 106(b) contracts should not be eligible for the alternative ceiling price. The Commission does not wish to hinder the integration of the interstate and intrastate markets, which the NGPA was intended to achieve, by fostering unnecessary price disparities between those markets. We note, however, that section 106(b) sales are not subject to Commission jurisdiction under the NGA. The Commission thus has serious doubt as to

[270] Indicated Producers at 70-71; Mesa Operating Limited Partnership.

whether it has authority to prevent automatic escalation of prices under section 106(b) contracts to the new ceiling by imposition of the good faith negotiation rule adopted as part of this order. We agree that producers subject to section 106(b) should not be precluded from receiving the new ceiling. At the same time we do not feel that purchasers should automatically be required to pay the new ceiling by virtue of indefinite price escalator clauses. Accordingly, the alternative ceiling will be applicable to section 106(b) sales, but the question of whether or to what extent 106(b) producers can obtain a higher price up to the ceiling shall be a matter for negotiation between the parties. Purchasers in such cases are not required to pay any price above the existing price unless they agree. We thus adopt the same rule for section 106(b) contracts as we have for minimum rate and fixed price contracts.

VI. Other Issues

A. *Block Billing.*

In its December 20, 1985, notice of procedural schedule, the Commission requested comments on the interrelationship between the block billing proposal in Docket No. RM85-1-000 and the DOE proposal, and whether the respective proposals were mutually exclusive, or might be merged or adopted concurrently. Block billing would require pipelines to bill their customers separately for old gas (Block 1) and new gas (Block 2). Block 1 old gas is gas which was committed to interstate commerce when the NGPA was enacted. This gas is subject to the relatively low price ceilings established by NGPA sections 104, 106(a), and 109. Block 2 new gas is gas whose price has been decontrolled or is subject to the relatively high incentive prices established by other sections of the NGPA. Under the block billing proposal, a pipeline's customers could purchase a specified percentage of the pipeline's Block 1 gas based on their level of purchases during the period 1979-1984.

Most commenters state that block billing and the DOE proposal are mutually exclusive. Producers, producing state representatives, and certain industrial customers assert that the DOE proposal is preferable to block billing on legal and policy grounds and should be adopted in lieu of block billing,[271] while most pipelines, distributors, and consumer commenters argue that the block billing proposal should be adopted rather than the proposed rule.[272] A few commenters reject both the DOE and block

[271] *See, e.g.*, Indicated Producers at 83-94; NGSA at 23-24; Independent Petroleum Association of Mountain States at 1-2; Interstate Oil Compact Commission at 4-5; IPAA at 6; PGC at 14; Applied Resources International, Inc., Executive Summary at 2-3; Council of Industrial Boiler Owners at 5-6; Chemical Manufacturers Association at 6-10; E.I. duPont de Nemours and Company at 27-29; Council of Energy Resource Tribes at 5; Mesa Operating Limited Partnership at 2; Mobil Oil Corporation, *et al.*, at 7-9; Montana Petroleum Association at 2; Mid Continent Oil & Gas Association at 3; Members of Congress Michael G. Oxley, William E. Dannemeyer, Dan Schaefer, Bob Whittaker, Jack Fields, and James T. Broyhill, letter at 1; Oklahoma Corporation Commission at 58; State of New Mexico at 9-13; Plains Petroleum Company at 18-21; Petrochemical Energy Group at 2-3; Southern Regional Energy Council at 2; Texas Land Commissioner at 2; Texas Railroad Commission at 4; Texas Independent Producers and Royalty Owners Association at 1-4; Texaco Inc. at 5-10; Union Texas Petroleum at 1.

[272] *See, e.g.*, MPC-NASUCA at 19-24; Arkansas Public Service Commission at 8-12; Public Utilities Commission of the State of California at 39-41; Public Service Company of Colorado at 11; Columbia Gas Transmission Corporation at 9-10; Public Service Commission of the District of Columbia at 9; Laclede Gas Company at 6; State of Minnesota at 9; Michigan Consolidated Gas Company at 22-23; Northern Distributor Group at 13; Pennsylvania Office of Consumer Advocate at 11; Peoples Natural Gas Company at 3; Southern California Gas Company at 38; Texas Intrastate Natural Gas Pipelines at 3; Western Gas Interstate Company at 7-8; CLEC at 19-24. Some commenters who prefer the block proposal suggest modifications thereto, such as subdividing block 2 gas still further into market-responsive, and non-market responsive gas, or reallocating the base periods for access to the respective blocks. *See, e.g.*, AGD at 11-12; AGD at 13 adopting AGA com-

billing proposals.[273] Several commenters suggest that the block billing and the DOE proposal could and should be implemented concurrently,[274] while a few commenters argue that while they could be implemented concurrently, they should not be because of the philosophical and policy differences in the two proposals.[275] Those parties that suggest the proposals could be concurrently implemented provide little guidance as to how this would be accomplished either practically or procedurally.

The Commission concurs with the overwhelming view of parties commenting on this issue that the block billing and DOE proposals are to a large extent mutually ex-

ments; Midcon Corporation at 39-40; Consolidated Edison Company of New York at 1; Memphis Light, Gas and Water Division, City of Memphis, Tennessee at 14-15; Public Utilities Commission of Ohio at 7-8; Northern Indiana Public Service Company at 18-22; Northern Illinois Gas Company at 26-28; Public Service Commission of the State of New York at 1; Pennzoil Company and Pennzoil Producing Company at 8-9; Peoples Gas Light and Coke Company and North Shore Gas Company at 23-26; Southwest Gas Corporation at 8; San Diego Gas and Electric Company at 5.

[273] *See, e.g.*, Northern Natural Gas Company at 11-12; Questar Corporation at 3; Public Service Commission of the State of Wyoming at 1-4. One commenter, UDC at 16, neither opposes nor supports block billing but opposes the DOE proposal.

[274] *See, e.g.*, Illinois Commerce Commission at 17-20; Baltimore Gas & Electric Company at 7; Columbia Gas Distribution Companies at 7-9; Citizens Energy Corporation at 5-6; Consolidated Edison Company of New York, Inc. at 1-2, Pennzoil Company and Pennzoil Producing Company at 8-9.

[275] *See, e.g.*, DOJ at 34, n.71 ("the Commission could . . . consistently adopt both block billing and the DOE proposal.") DOJ believes, however, that block billing would be "obsolete" to the extent the old price cushion will be eliminated. Other commenters, while agreeing that the proposals may lawfully be implemented concurrently, express their preference for the block billing proposal. *See, e.g.*, Arkansas Public Service Commission at 8-12; Public Service Company of Colorado at 8; State of Minnesota at 9; Public Utilities Commission of Ohio at 7-8; Northern Illinois Gas company at 26-28.

clusive and that it is questionable whether they could be combined or if so what the likely consequences would be. However, we will not terminate the block billing proposal at this time. Rather, the Commission will review the matter in light of the operation of this rule in actual practice and will take such further action in Docket No. RM85-1-000 as is found to be reasonable or necessary.

B. *Department of Justice Alternative Proposal.*

DOJ offers a comprehensive alternative to DOE's proposal which would go beyond that proposal to effectively deregulate all natural gas prices. DOJ contends that since the natural gas market is workably competitive, market-based rates will best achieve the Commission's statutory mandate to assure just and reasonable rates. The market will protect consumers from excessive rates while encouraging production of adequate supplies. Accordingly, DOJ proposes that the Commission exercise its authority under NGPA sections 104(b)(2)(B), 106(c), and 109(b)(2) to declare that any price paid for gas subject to sections 104, 106, and 109 is presumed just and reasonable within the meaning of the NGA. The only exception would be where there was fraud, abuse, or other similar conduct. DOJ would require parties to existing contracts with indefinite price escalation clauses to negotiate a new just and reasonable price. It recommends the Commission do this by cancelling any rate schedule currently on file pursuant to an indefinite price escalation clause. Where the parties fail to renegotiate the contract, the producer could seek expedited abandonment, and there would be a presumption that abandonment is permitted by the public convenience or necessity. Similarly, after any existing contract expired, the producer could seek expedited abandonment with a presumption favoring such abandonment.

While the Commission agrees with DOJ that in a competitive market such as that for natural gas, market-based rates provide the most efficient allocation of resources, the Commission feels constrained to reject the DOJ proposal as beyond its authority. The DOJ proposal amounts to total deregulation of old gas prices. The NGPA does not give the Commission authority to do this. The Commission's authority under NGPA sections 104(b)(2)(B), 106(c), and 109(b)(2) is limited to prescribing "a maximum lawful ceiling price," higher than that otherwise applicable, which is just and reasonable within the meaning of the NGA. Thus, although the Commission can increase existing ceiling prices, Congress nevertheless required that the Commission prescribe some maximum lawful price. DOJ, however, would have the Commission go beyond the prescription of a new maximum lawful ceiling price and effectively remove all ceiling prices. If, as DOJ suggests, all contract prices are presumed just and reasonable, no ceiling price remains.

That Congress did not intend to give the Commission authority to deregulate old gas prices completely is further shown by the NGPA's requirement that the new price be just and reasonable within the meaning of the NGA. The Commission has no authority to deregulate prices under the NGA. As the Circuit Court of Appeals for the District of Columbia stated shortly before enactment of the NGPA, "If a decision is to be made to deregulate natural gas prices, it must be made by Congress, not by the [Commission]." [276] Accordingly, the Commission must respectfully decline to adopt DOJ's proposal.

C. *Incentive Price Proposal.*

In light of the comments submitted in this proceeding, the Commission has concluded that there are some remaining open issues with regard to the basis for the incentive

[276] *Public Service Commission of New York v. FERC*, 589 F.2d 542, 550 (D.C. Cir. 1978). *See also, FPC v. Texaco, Inc.*, 417 U.S. at 397-98.

price portion of the DOE proposal at this time. Therefore, we are still reviewing the matter and will rule on the incentive price proposal in a separate order to be issued at a later date.

D. *Transportation Authority.*

A number of commenters express the concern that pipelines may release gas under the good faith negotiation rule but then refuse to provide transportation to another purchaser. As one producer commenter puts it, "[t]he pipeline which can refuse to transport the released gas to an alternative market is in a position to extract unreasonable concessions from the producer, or even to refuse to negotiate at all." [277] To remedy this perceived deficiency in transportation availability, NGSA proposes that pipelines be allowed to transport gas released as a result of the good faith negotiation process without becoming subject to open-access transportation obligations under Order No. 436.[278] In a similar vein, Indicated Producers state that a blanket transportation certificate should be granted to non-open-access pipelines which would authorize those pipelines to transport released gas on behalf of the seller or the new buyer.[279] Certain industrial end-users suggest that in order for a producers' sections 104 and 106 gas to be eligible for the higher just and reasonable price, the producer should first be re-

[277] *Texaco Inc.* at 11-12.

[278] *See* NGSA at 28. *See also, e.g.*, Indicated Producers at 68 ("to the extent pipelines do not accept open access transportation certificates [under Order No. 436], . . . the Commission must adopt a policy or negotiation process which would assist in providing transportation of released gas, whether or not Order No. 436 certificates are widely used.") Attached to this preamble as Appendix B is a list of the 34 pipelines that, as of the issuance of this rule, have filed under Order No. 436 or have otherwise announced their intention to negotiate settlements in order to file under Order No. 436.

[279] Indicated Producers at 68.

quired to file an affidavit agreeing to renegotiate fully its contracts covering gas other than old gas with any interstate pipeline that accepts Order No. 436.[280] The purpose would be to entice pipelines to elect open-access transportation under Order No. 436 in exchange for the opportunity to renegotiate uneconomic contracts. In return, transportation would be assured for sections 104 and 106 gas released under the good faith negotiation process.

The Commission has considered carefully the requests for blanket transportation of gas released under the good faith renegotiation process or for transportation authority without triggering the open access requirements of Order No. 436. We conclude that this rule should establish reasonable procedures by which gas which is released pursuant to the good faith negotiation procedures can be transportated by pipelines not under Order No. 436. It is clear that for the potential benefits of this rule to be realized in terms of both supply and price response, released gas must be able to be marketed. However, without Commission action, there is no assurance that first sellers will be able to market their released gas unless their existing purchasers have accepted the terms and conditions of Order No. 436. We believe it is essential to formulate reasonable and fair transportation provisions in light of the revised good faith negotiation procedures adopted as part of this rule so as to assure the availability of transportation service irrespective of whether a particular purchaser has or has not accepted the open-access obligations of Order No. 436. Consequently, we will provide for the availability of conditional transportation services by pipelines not under Order No. 436.

As an integral part of the new ceiling price and the good faith negotiation procedure itself, the Commission is including limited authority for an existing pipeline purchaser to transport gas released under the rule. The Commission also is deeming the releasing pipeline to agree

[280] *See* PGC at 4.

to transport such gas to its existing customers or any interconnecting pipeline, as a condition of the ability of the existing pipeline purchaser to terminate purchases of gas from a first seller under the rule. The purpose of this limited transportation authority is to assure that the prices of gas renegotiated under the rule are subject to the maximum benefits of competitive pressures by alternative buyers and sellers in gas markets. Without access to transportation, the renegotiation process would be insulated from these competitive benefits, and both producers and pipelines would be restricted in their access to gas supplies released under the rule. At the same time, the Commission considers the limited transportation authority as an essential element of the firm sales customers' right of first refusal to old gas released by their pipeline suppliers under the rule. For a firm sales customer, especially a full requirements customer with no access to alternative suppliers, the right of first refusal cannot be exercised in any practical way to avoid the loss of old gas off-system under the rule unless the customer has meaningful access to transportation. Under the good faith negotiation procedure, the existing pipeline purchaser may choose or not choose to terminate purchases of gas under an existing contract with a producer. As a condition on the pipeline's exercise of these options, the limited transportation authority is reasonably intended to assure that the pipeline's existing customers, especially firm sales customers, have a practical means of keeping the gas on-system and getting it transported for their use.

Under the good faith negotiation rule proposed by DOE, indefinite price escalator clauses in old gas contracts are prevented from becoming automatically operative, and pipelines are provided the opportunity to negotiate the price they are willing to pay up to the new ceiling price. In the event no price agreement is reached, the producer has the right to abandon the sale. The procedures adopted by this rule conform to DOE's proposal

in providing for producer abandonment in cases where the producer seeks to renegotiate the price of old gas but is unable to do so. This rule also modifies DOE's proposal by providing that in various circumstances purchasers may request price renegotiation of higher-priced categories of gas and may discontinue purchasing such gas in cases where no agreement on repricing is reached. The good faith negotiation procedures adopted by this rule thus extend to purchasers significant and substantial rights in addition to those incorporated in the rule as proposed by DOE. The Commission finds that it is reasonable and consistent with the objectives of this rule to make the exercise by purchasers of their rights under the good faith negotiation rule conditional upon the availability of transportation services for gas released pursuant to the rule. We have previously determined that the existing old gas price structure is inefficient or unjust and unreasonable and should be replaced by a uniform, alternative just and reasonable ceiling price equal to the post-1974 price. In most instances, first sellers would be unable to market released gas to alternative purchasers unless the existing purchaser agreed to transport the gas or is an Order No. 436 transporter. The existing purchaser would have little or no incentive to do so, however, because in the absence of transportation the first seller would have little alternative but to continue selling to the existing purchaser at the current price. The result would frustrate the purposes of this rule and force the first seller to accept a price which we have found to deny both consumers and producers the full benefits of competition and long-term reliable gas service under the NGPA and NGA. We therefore believe that the good faith negotiation procedures would be ineffective to accomplish the goals of this rulemaking unless combined with a transportation provision designed to encourage purchasers to negotiate in good faith and to provide first sellers with reasonable access to an alternative market in the event no agreement on pricing is reached.

Consequently, the Commission is providing for conditional transportation services under its NGPA authority to condition the new ceiling price under sections 104(b)(2) and 106(c), as well as under its NGA authority to determine that the existing ceiling price structure for old gas is in need of revision or otherwise unjust and unreasonable pursuant to section 5(a) of the NGA. The Commission need not specifically find that the failure to condition the new ceiling price with a transportation provision would cause the new ceiling price to be unjust and unreasonable under section 5(a) of the NGA. However, the Commission is so finding here, because it considers access to transportation for gas released under this rule to be essential for the protection of consumers and the achievement of market-responsive gas prices intended by the final rule.

We have previously determined that firm sales customers of the existing purchaser should have a right of first refusal enabling them to match any third-party offer to purchase gas released pursuant to this rule. We believe that in cases where firm sales customers exercise their right of first refusal and thereby agree to purchase released gas, the existing purchaser should be deemed to have agreed to transport that gas to the purchasing firm sales customer. Our reasons for this determination are the same as those underlying our decision to grant firm sales customers the right of first refusal as to gas abandoned under this rule. We will also provide that an existing pipeline purchaser shall transport abandoned gas to any of its customers and any interconnecting interstate, intrastate, or Hinshaw pipelines [281] on behalf of any person who purchases abandoned gas. Our decision to include this additional conditional transportation service is designed to provide the releasing pipeline's customers and interconnected pipelines and their customers access to gas released pursuant to this rule. In addition,

[281] *See* NGA section 1(c); 15 U.S.C. § 717(c) (1982).

we seek to provide first sellers with reasonable access to transportation service. We believe that providing for transportation of released gas to customers of the transporting pipeline and to interconnecting pipelines, regardless of who purchases the released gas, will provide first sellers with sufficient access to alternative markets to insure that the purposes and objectives of this rule will be realized. This additional sales market will assure that wellhead markets remain workably competitive, that producers have access to a substantial market as an alternative to continuing sales to the existing purchaser, and that firm sales customers of the releasing pipeline interested in exercising their right of first refusal can obtain the benefits of these competitive forces.

We will therefore consider that in cases where any gas is released from a particular contract under the good faith negotiation procedures, the former pipeline purchaser is deemed to agree to transport the released gas to any of its customers who purchase such gas or to any pipeline with which it is interconnected, upon 30-days written notice from the first seller to the transporting pipeline. The transportation provision, to which releasing pipelines are deemed to have agreed to perform under the good faith negotiation procedures, attaches to the released gas and is not provided for the benefit of any particular purchaser. Therefore, transportation of the released gas through the releasing pipeline on behalf of any purchaser requesting such transportation will continue until the supply is exhausted, or authorization for transportation of such gas ceases upon the expiration of a contract where a pipeline subsequently becomes subject to Order No. 436. In order that the transportation of released gas can be commenced without unnecessary delay or regulatory cost to the pipeline, the Commission will grant a blanket transportation certificate under section 7(c) of NGA to jurisdictional natural gas pipelines not already transporting under Order No. 436. Transportation under the blanket certificate shall be provided as far

as practicable in accordance with the terms and conditions requested by the first seller and its purchaser. The rate to be charged shall conform to the requirements of new section 284.225(d) of the Commission's regulations promulgated as a part of this rule. In order to permit existing firm sales customers to obtain full and immediate access to gas released under the rule and subject to the right of first refusal, such customers will be able to obtain transportation of such gas within their existing firm sales contract demand without incurring costs beyond what they would have incurred in purchasing the gas from the releasing pipeline.

Pipelines transporting gas under the blanket certificate shall not become subject to the open-access requirements of Order No. 436 (18 C.F.R. §§ 284.8(b) and 284.9(b) by reason of such transportation. Any pipeline which is not subject to the open-access requirements of Order No. 436 and which is requested by the first seller to provide transportation service may apply for a separate transportation certificate under section 7(c) of the NGA. The Commission finds that any refusal by a pipeline to transport gas abandoned under the good faith negotiation procedure would constitute an unduly discriminatory or preferential practice violating section 5(a) of the Natural Gas Act because the refusal could be used by a pipeline as a "bargaining chip" or tying arrangement in establishing a renegotiated price under an existing contract for the sale of old gas under the final rule. The Commission also considers that such a refusal to transport could constitute a violation of antitrust law if it amounts to an effort by a pipeline to extend its regulated monopoly power over access to transportation services to wellhead gas markets that are workably competitive under the mandate of the NGPA. The Commission will carefully scrutinize any such refusals to transport or tying arrangements and intends to fully enforce its obligation under the Natural Gas Act and other law.

E. Blanket Sales Certificates.

Tennessee Gas Pipeline Company asserts that the proposed rule is flawed because it lacks any requirement that a producer first obtain a certificate of public convenience and necessity prior to any new sale for resale in interstate commerce of gas abandoned as a result of the good faith negotiation process.[282] In response to this concern and in order to effectuate the contract renegotiation and market-responsive pricing objectives of the good faith negotiation procedure, the Commission is incorporating a blanket certification authorization into the rule, with a concomitant pre-granted abandonment authorization. These authorizations will permit a producer to sell gas abandoned as a result of the good faith negotiation rule to a new purchaser and to abandon the sale at the end of the contract.

The Commission finds that such blanket sales certificates with pre-granted abandonment are permitted by the public convenience and necessity. Without a blanket certificate, producers would have to file an application for a certificate (filing fee $2,800 for a large producer) for each jurisdictional sale they proposed to make. This would be costly to producers, administratively burdensome, and hinder smooth implementation of this rule. Regulatory delay in obtaining required certificates and abandonment authority tends to place jurisdictional customers at a competitive disadvantage vis-a-vis non-jurisdictional entities not affected by such requirements. As a result, the relatively low-cost gas made available by the operation of the rule would not be as readily available to many LDC's and their customers as it would be to intrastate customers. Congress intended through enactment of the NGPA to establish equality of marketing opportunities as between the interstate and intrastate

[282] *Tennessee Gas Pipeline Company* at 9.

markets.[283] Accordingly, the public convenience and necessity is served by granting blanket certificate and abandonment authorization.

This action is comparable to the Commission's recent orders in *Pennzoil Producing Company and Pennzoil Gas Marketing Company*, Docket Nos. C186-54-000 and C186-57-000, 34 FERC ¶ 61,318 (1986). Pre-granted certificate and abandonment authorization are also fully consistent with the overall objectives of this rule. By allowing old gas to be marketed to the jurisdictional market without unnecessary regulatory delay, the blanket procedure promotes the supply and price benefits of the rule in both the interstate and intrastate markets.

The NGPA with its phased system of deregulation (section 121) and its limitations on the Commission's Natural Gas Act jurisdiction (section 601), was crafted to lessen the disparities in regulation of interstate and intrastate gas, thereby facilitating a national market based on freer competition. Where the Commission's NGA jurisdiction remains, common sense dictates regulatory policies (such as the traditional case-by-case certification processes) that were grounded in a pre-NGPA era should be pragmatically updated. Congressional purposes are furthered by adapting our certificate procedures to the evolving national competitive environment that was the goal of Congress in enacting the NGPA. Making the Commission's certification function more flexible is legally compatible with the freer competitive market intended by the NGPA, even for those portions of the industry that remain regulated by the Commission. The Commission has adopted the same rationale in eliminating other regulatory vestiges of the pre-NGPA gas industry era. For example, in eliminating pipeline minimum take provisions the Commission observed: [284]

[283] Congress intended the NGPA to end the anomaly of ample supplies in the intrastate market and the recurring, severe shortages in the interstate market that existed during the Seventies. The NGPA's pricing scheme was intended to increase the supply of gas reserves and production and to decrease distorted consumption demand at the end-use level. The Commission's intention in this rulemaking is to serve those ends. The provision of blanket sales certificates is intended to maintain the uniformity of national market opportunities intended by the Act. *See*, H.R. Rep. 496, pt. IV, 95th Cong. 1st Sess. 101 (1977); Congressional Budget Office, The Natural Gas Compromise Report 2 (1978), *reprinted in* 124 Cong. Rec. H13126-27 (daily ed. Oct. 4, 1978) The Commission in implementing other provisions of the NGPA has similarly responded to the need to keep opportunities in jurisdictional and non-jurisdictional markets equal. *See e.g.* Order No. 108-A 48 FR 48223 (Oct. 18, 1983) ("This order on rehearing affords [intrastate] sellers of gas . . . the same opportunity to collect an allowance for State severance taxes under section 110(a)(1) as the Commission has afforded sellers of interstate gas.")

> As the Commission stated in *City of Florence, Alabama v. Tennessee Gas Pipeline Co.*, 24 FERC ¶ 61,395, at 61,839 (1983), competition can and should play an important role even in a regulated industry such as the natural gas industry. "If competition exists, incentives are created for innovation by the regulated companies. This, in turn, encourages lower prices and better service." This is precisely what the Commission is attempting to do by adapting our regulations to respond to evolving competitive forces.

It is reasonable to make certificate procedures more flexible to serve the purposes of this rule. In doing so, the Commission is simply adapting its regulations to respond to evolving industry and market conditions. Given the competitive environment of today's natural gas market, blanket sales certificates will encourage lower prices and better service nationwide.

[284] Order No. 380-C, 49 FR at 43626 (Oct. 31, 1984), *aff'd*, *Wisconsin Gas Co. v. F.E.R.C.*, 770 F.2d 1144 (D.C. Cir. 1985), *cert. denied*, 54 U.S.L.W. 3761 (U.S., May 19, 1986) (No. 85-1219).

F. *Response to Administrative Law and Procedural Claims*

During this proceeding, the Commission received a variety of pleadings that pose procedural requests and objections. Motions, petitions, applications, and answers have no special procedural significance in informal rulemakings, and the Commission therefore disposes of these pleadings here as it would other comments. Elsewhere in this order, the Commission addresses the important substantive issues underlying these pleadings. It therefore makes clear at this point only the results of its review of other issues presented, as follows.

1. Associated Gas Distributors (AGD) filed on January 17, 1986, a petition requesting additional discovery and comment procedures. The petition, submitted early in the Commission's 60-day initial comment period,[285] outlined a variety of formal procedures designed allegedly to facilitate information gathering by the commenters and the Commission, including the submission of interrogatories to the Secretary of Energy for his response,[286] discovery among participants in the proceeding pursuant to special Commission procedures, additional time to accommodate "this more rigorous informational process," and an opportunity to file comments in reply. AGD supplied the Commission with a memorandum of law empahsizing the factual nature of any decision that would implement the DOE proposal in this proceeding.[287]

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[285] On February 19, 1985, AGD requested 30 additional days to file initial comments. The Commission allowed reply comments instead.

[286] AGD requested such procedures under the general and discretionary provisions of Section 403(d) of the Department of Energy Organization Act (DOE Act), 42 U.S.C. § 7173(d) (1982).

[287] The AGD memorandum alleges that the DOE failed to provide adequate notice of the information underlying its proposal, in violation of Section 501(b)(1) of the DOE Act, 42 U.S.C. § 7191 (b)(1) (1982). The Commission does not believe that Section

United Distribution Companies (UDC) filed in support of the AGD petition. DOE also answered the AGD petition, committing itself to providing additional analytical support for the rule.

The Commission recognizes AGD's concern that an action to raise the maximum lawful price of old gas, subject to the good faith renegotiation of existing contracts, must be the product of thorough investigation and a reasoned analysis of substantial evidence in the record. The Commission nevertheless firmly believes that it has developed a sound and comprehensive record, without the unnecessary formality and procedural complexity requested by AGD. As requested, the Commission provided an opportunity for submittal of reply comments by any interested persons. The reply comments tested the soundness of the data and arguments submitted in initial comments. The Commission provided for yet another opportunity to present data and views when it held two days of public hearings on the rule. All segments of the gas industry, the public, and state regulators participated.

501(b)(1) is applicable to this proceeding. To the extent that it may apply, however, the Commission finds no deficiency in the DOE proposal, which fully apprised the public of the legislative facts and policies relied on by the Secretary. For any rulemaking, such as this one, governed by the notice requirements of the Administrative Procedure Act, the DOE proposal contains far in excess of the minimum of necessory information. It is both unusual and unnecessary for a notice of proposed rulemaking to exhibit the same quantum of data that is normally developed by the participants in the proceeding and utilized by the agency for a final rule. Comment procedures are not mere formalities that led to foregone conclusions.

AGD also filed with DOE a Freedom of Information Act request for all cost and other factual data relating to its proposed rule. DOE subsequently filed in this proceeding the data that it provided in response to that request.

The Commission's December 20, 1985 notice of procedural schedule also expressly requested commenters to include quantitative and qualitative data in their comments, and the record in this proceeding includes numerous responses to this request.

Most participants presented written and oral testimony in response to the initial and reply comments, including additional analytical material for the record. As a consequence of these thorough information-gathering procedures, the record contains a lively debate of the issues and full analyses of the data presented to the Commission. DOE, as well as other commenters, supplied the Commission with extensive quantitative and qualitative studies and analyses discussed throughout this order. In light of the extensive public procedures, the issues in this rulemaking have been fully ventilated and the evidentiary record is complete.

2. On February 10, 1986, UDC filed a petition and supporting memorandum requesting immediate and summary dismissal of the DOE proposal on grounds that the Secretary "would have the Commission embark upon a rulemaking that completely contravenes established bounds of the Commission's authority . . . [under] the Natural Gas Act and Natural Gas Policy Act." Although UDC characterizes its complaint as involving jurisdictional issues, the pleading in fact pertains to whether the Commission has sufficient information and authority to implement the DOE proposal and could do so in a reasoned manner. As this order demonstrates, the Commission does not concede UDC's allegations that its authority is so severely restricted that it is foreclosed from even considering the issues presented by DOE. In any event, the rulemaking process is designed to afford a fair and open examination of such issues by affected parties; summary dismissal would be inappropriate for such proceedings.

3. On May 12, 1986, the American Gas Association (AGA) petitioned the Commission for additional procedures similar to those requested earlier by AGD to permit further development of the record in this proceeding.[288]

[288] Answers to AGA's petition were filed by the Indicated Producers, Northern Illinois Gas Company, Office of the Consumers' Counsel, State of Ohio, and Southern California Gas Company.

AGA requests that the Secretary be required to respond to written questions and that discovery among all participants to this rulemaking be sanctioned by the Commission. Based on its review of the entire record, AGA alleges various evidentiary deficiencies that it contends renders the Commission incapable of taking legally defensible actions on core issues.

The Commission recognizes that factual disputes and policy disagreements exist in the record. It is convinced that by providing for initial and reply comments and a public conference, the Commission has fulfilled its statutory obligations under applicable rulemaking procedures.[289] These procedures have also met the goals of the AGA and other commenters who seek and deserve a critical and thorough examination of the views and information related to the repricing of old gas supplies. Rulemaking proceedings need not resolve all disputes of fact on such subjects. It is enough that a decisionmaker afford an ample and equal opportunity to participate and, if it believes that the evidence is adequate, make its decision in a reasoned manner. The addition or repetition of information-gathering procedures does not necessarily ensure a better or more complete record, in terms of the quality of the data submitted or how well the participants or the decisionmaker use the information. The Secretary's deadline for final Commission action notwithstanding, this rulemaking has not been attenuated. The Commission therefore concludes that it has in this record sufficient information upon which to decide the key issues to which the AGA points. It therefore declines to delay further its consideration of final action based on that record.

[289] *Wisconsin Gas Co. v. FERC*, 770 F.2d 1144, 1167-68 (D.C. Cir. 1985), *cert denied*, 54 U.S.L.W. 3761 (U.S., May 19, 1986) (No. 85-1219) (*citing Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council, Inc.*, 435 U.S. 519 (1978) and *American Public Gas Association v. FPC*, 567 F.2d 1016 (D.C. Cir. 1977).

4. On May 23, 1986, the American Gas Association, Associated Gas Distributors, the Interstate Natural Gas Association of America, and United Distribution Companies filed a joint petition requesting the Commission to delay the effective date of this rule for 120 days after the issuance of an order on rehearing. The petitioners argue that unless the effective date is deferred, permanent and irreversible actions may be taken by the parties before there is an opportunity to test the legal merits of the order. Petitioners are concerned that reserves may be lost if producers abandon sales under the good faith negotiation provision or that markets may be lost if pipelines must pay higher prices for old gas.

The Commission believes that this final rule will provide price and supply stability to the gas markets, and that the parties represented by petitioners will not be disadvantaged as they allege. However, the Commission separately has concluded for other reasons discussed below, that implementation of the renegotiation provision should be delayed.

The Commission independently recognizes that the order will affect thousands of gas purchase contracts. The changes to the marketing of natural gas established by the rule are complex. Because of the importance of the rule for the gas industry, the Commission has concluded that more time than proposed by DOE may be needed by the parties to the contracts to determine if, when, and under what terms to renegotiate. Delaying implementation of the good faith negotiation provision until the fall would allow the parties time to examine the economic consequences of the final rule and engage in voluntary renegotiation of their contracts outside of the good faith negotiation procedures.

While the Commission agrees with the petitioners that the portion of the rule requiring renegotiation should be delayed, it does not agree that it should be delayed 120 days from the order on rehearing. The Commission at

this time is unable to determine when an order on rehearing may be issued and is reluctant to delay the implementation of any portion of the rule other than to a date certain. Such an unwarranted delay would unjustifiably delay the market-responsive pricing and supply benefits to consumers intended by the final rule. Therefore, the Commission is delaying the effectiveness of the renegotiation provision of the rule until November 1, 1986.

VII. Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA) [290] generally requires a description and analysis of final rules that will have a significant economic impact on a substantial number of small entities.[291] Specifically, if an agency promulgates a final rule under the Administrative Procedure Act (APA),[292] a final RFA analysis may be appropriate. A final RFA analysis must contain (1) a statement of the need for and objectives of the rule, (2) a summary of the issues raised by the public comments in response to any initial regulatory flexibility analysis, and the agency response to those comments, and (3) a description of significant alternatives to the rule consistent with the stated objectives of the applicable statute that the agency considered and ultimately rejected. An agency is not required to make an RFA analysis, however, if it certifies that a rule will not have "a significant economic impact on a substantial number of small entities." [293]

As discussed, the Commission believes it must revise its regulation of old, flowing gas prices under the authority of the NGPA sections 104 and 106 because its regulation has created and continues to promote a wide disparity between wellhead prices for natural gas. In particular,

[290] 5 U.S.C. 601-612 (1982).

[291] *Id.* 604(a).

[292] *Id.* 553.

[293] *Id.* 605(b).

the Commission's past regulation fostered prices of old, flowing gas that are unresponsive to changes in wellhead markets, fail to assure that city-gate prices reflect the cost of replacing depleted gas reserves, directly contribute to the "boom and bust" tendency of investment in the gas industry, and inhibit consumers from receiving the full benefits of wellhead competition as Congress intended by enacting the NGPA.

As permitted by the RFA, the Commission certified that the rule proposed by the Secretary of Energy, if promulgated, would not have a significant economic impact on a substantial number of small entities. The Commission concluded that the proposed rule would have a positive impact on the small entities subject to the rule. By raising the maximum lawful price of gas regulated under NGPA sections 104, 106 and 109, the DOE proposal would have enabled small producers that sell old flowing gas to improve their revenues and enhance their ability to sell that gas. Since the RFA requires the Commission to analyze only the impacts on small entities that will be subject to the rule,[204] the Commission concluded that the economic impact of the proposed rule would not be "significant" within the meaning of the RFA, since the impact on these small entities was expected to be beneficial.

Generally, this rule adopts the DOE proposal with modifications, especially to the "good faith negotiation" rule. Specifically, the Commission provides that each pipeline-purchaser has the right, similar to the producer's right, to request a producer to nominate new prices for the producer's gas, if the producer has requested the pipeline to nominate higher prices for old gas which the producer believes is being sold at below-market prices. In other words, the pipeline is entitled to request a new price for

[204] *Mid-Tex Electric Cooperative Inc. v. FERC.*, 773 F.2d 327, 340-43 (D.C. Cir. 1985).

the producer's old gas and any other gas sold under any contract containing old gas, if the producer requests the pipeline to nominate a price for old gas. In this way, the producer has the option to seek higher prices for its old gas, but that producer must be ready to renegotiate the price of any gas sold under any contract that contains old gas, if it exercises this option. The Commission believes that this modification provides producers and pipelines balanced negotiating positions, but protects small producers by permitting each producer to decide whether it is to its benefit to seek higher prices for its old gas.

Several commenters disagree with the Commission's certification that the proposal would not, if adopted, cause "a significant economic impact on a substantial number of small entities" wthin the meaning of the RFA. They contend that the Commission's certification under the RFA is flawed because the Commission considered only an unspecified number of the Nation's approximately 10,000 natural gas producers as small entities and mistakenly predicted that a beneficial economic impact on these small entities will result from the implementation of the proposed rule.

In particular, Northern Indiana Public Service Company (NIPSCO) asserts that the Commission improperly restricted its consideration under the RFA to natural gas producers. NIPSCO maintains that the definition of small entities includes small businesses as defined under section 3 of the Small Business Act, small non-profit organizations and small governmental jurisdictions such as cities and towns with populations of less than 50,000 persons. NIPSCO believes that far more such small entities than simply natural gas producers will suffer significant economic impacts from higher old gas prices. In addition, AGA argues that the Commission's certification ignores the economic impacts of the proposal on such small entities as small distributors and other small gas purchasers, which account for millions of jobs and could be deva-

stated by an increase in the price their pipeline suppliers would be required to pay for old gas under the proposed rule.

AGA also asserts that a large number of small producers will be financially injured if lower prices for high-cost gas result from the proposal. If new gas prices do not fall as much as old gas prices rise under the proposal, however, a large number of small gas distributors and their customers will also be financially injured, maintains AGA. Similarly, the Texas Independent Producers and Royalty Owners Association (TIPRO) expresses concern for its membership whose high-cost contracts could be renegotiated downward under the proposal. TIPRO believes that "tens of thousands" of small entities will be adversely affected without receiving a corresponding benefit in exchange.

The Commission believes that these commenters misunderstand the intent of the RFA. As NIPSCO notes, the definition of small entity includes small businesses as defined under section 3 of the Small Business Act, small non-profit organizations and small governmental jurisdictions. So, the Commission need not analyze the effect on large producers in deciding whether there will be a significant impact within the meaning of the RFA. In addition, the Commission does not consider the effect on pipeline purchasers when it certifies no impact because most jurisdictional natural gas pipelines do not fall with the RFA's definition of small entity; they are (1) too large to be considered "small entities", or (2) holders of exclusive selling rights within a respective field of operation and are therefore dominant in that field of operation. Similarly, commenters' arguments that the Commission must consider the effects of this rule on small end-users, royalty interest owners, and every small producer selling gas in the United States overstates the proper application of the RFA. In particular, Congress was not asking agencies to study any potential economic

effect on any small entity even if only indirectly affected by the rule. As noted in previous proceedings,[295] this Commission, like other agencies,[296] is required by the RFA to analyze only the effect of rules on regulated small entities to which the requirements of the rule apply.[297] Congress was clear about the reach of the statute: when an agency issues a rule that applies to small entities, the agency must consider, and try to mitigate, the burden on those small entities of compliance with the rule.[298] The legislative history also echoes a concern about burdensome reporting and compliance requirements.[299]

Although Commission regulation affects in some way all small end-users, small royalty owners, and small producers, neither small end-users, small royalty owners, nor small producers that do not sell NGPA section 104 or 106 gas are subject to the requirements of this rule. In particular, the Commission believes that, because of increased volumes of relatively inexpensive old gas on the market,

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[295] Construction Work in Progress for Public Utilities; Inclusion of Costs in Rate Base, 48 Fed. Reg. 24,323 (June 1, 1983) (Docket No. RM81-38-000) (Order No. 298 *rehearing granted in part and denied in part*, 48 FR 46012 (Oct. 11, 1983); Elimination of Variable Costs from Certain Natural Gas Pipeline Minimum Commodity Bill Provisions, 49 FR 22778 (June 1, 1984) (Docket No. RM83-71-000) (Order No. 380), *order on rehearing*, 49 FR 31,259 (Aug. 6, 1984).

[296] *See, e.g.*, 47 FR 5215 (Feb. 4, 1982) (final rule of Securities and Exchange Commission).

[297] *Mid-Tex Electric Cooperative Inc. v. FERC*, 773 F.2d at 342 (No RFA analysis is necessary when the agency determines that the rule will not have a significant economic impact on a substantial number of small entities that are subject to the requirements of the rule).

[298] *See* Congressional Findings and Declaration of Purpose, section 2, Pub. L. No. 96-354, codified at 5 U.S.C. 601, note (1982).

[299] For a discussion of the legislative history, *see* Elimination of Variable Costs from Certain Natural Gas Pipeline Minimum Commodity Bill Provisions, *supra*, 49 FR at 22791.

many producers that sell high-cost gas not subject to NGPA section 104 or 106, including some small producers, may not be able to continue to collect the current above-market price for gas that may be allowed under existing contracts. This is an intended effect of this rule. However, these small producers are not subject to the requirements of this rule and, therefore, the RFA does not require separate analysis of the effects on them when the Commission decides whether an RFA certification is appropriate. Of course, the response of the gas markets, including these high-cost gas contracts, to the renegotiation upward of low old gas costs is a primary focus of this rulemaking.

Direct effects of the rule on small producers is as follows. As explained earlier, this rule would raise the maximum lawful prices for NGPA sections 104 and 106 gas for (1) all new contracts executed after July 18, 1986, and (2) contracts with indefinite price escalator clauses in effect on July 18, 1986, if the producer elects to seek a higher price for some or all of its NGPA sections 104 and 106 gas. The Commission believes that the effect on small producers that have NGPA sections 104 and 106 gas reserves to sell will primarily be beneficial for the following reasons, as well as the reasons cited in this preamble generally, *supra*.

The rule requires a small producer to decide whether to seek a higher price for some or all of its old gas. If the producer does not seek a higher price for its gas, the rule has no effect on the price or service obligation imposed on that small producer under its existing contracts. In this way, if a small producer has contracts for old gas at prices above the market-price, that producer may continue to sell under these contracts without being subject to this rule.

In contrast, if the small producer requests a pipeline to nominate a higher price for some or all of its old gas, a pipeline may request that the producer nominate a

price for any old gas and any other gas sold under any contract containing old gas.[300] If the pipeline does not nominate the highest price provided by an existing contract or a price agreeable to the small producer for some of the producer's gas, the small producer is granted automatic abandonment, sales authority and the transportation by the original pipeline-purchaser necessary to market that gas if the producer finds a new purchaser. Similarly, if the pipeline refuses to accept the price nominated by the small producer for some of the producer's gas, the pipeline may terminate its purchases of that gas and the small producer is granted automatic abandonment, sales authority and the transportation by the original pipeline-purchaser necessary to market that gas if a small producer finds a new purchaser.

In essence, this rule protects small producers in two major ways. First, the rule permits a small producer to decide whether to participate in the good faith negotiation procedures for existing contracts. Second, the rule provides small producers that participate in the good faith negotiation procedures with abandonment, sales, and transportation authority to market its gas if the small producer and pipeline are unable to agree on a suitable price for some or all of the producer's gas.

The Commission chose this procedure in order to minimize or eliminate any adverse effects on small entities. It could have adopted an alternative of deeming that every contract for sale of NGPA sections 104 and 106 gas to have a "market-out clause" that would permit either the purchaser or the seller to terminate the contract upon notice, if the price is unsuitably above or below a particular established price. But this approach could cause unintended harms and hardships on small producers. Similary, the Commission could have adopted an alterna-

[300] The Commission notes that small producers have been exempt since 1971 from many of the Commission's rate and certificate filing requirements. 18 C.F.R. 157.40 (1985).

tive of not raising the maximum lawful price for NGPA sections 104 and 106 gas. The Commission decided that new MLP's were necessary to eliminate the distortions caused by Commission regulation, but determined that permitting producers to decide whether to seek higher prices for their gas would prevent unintended harms and hardships, particularly to small producers. By providing producers the option to renegotiate for a higher price for old gas, the Commission permits a small producer to choose the course of action that is most beneficial to that small producer.

For all these reasons, the Commission believes that this rule would be beneficial to small producers by raising the maximum lawful prices for NGPA sections 104 and 106 gas, increasing the ability of small producers to sell their gas, and increasing the price paid to small producers for NGPA sections 104 and 106 gas, without requiring any small producer to modify or change any contract for NGPA sections 104 and 106 gas. Since the impact on the small entities regulated by this rule is expected to be beneficial, the Commission does not believe that the economic impact will be "significant" within the meaning of the RFA. Pursuant to section 605(b), the Commission accordingly certifies that this rule will not have a "significant economic impact on a substantial number of small entities."

VIII. Effective Date and Paperwork Reduction Act Statement

1. The rule becomes effective July 18, 1986; however no producer may make a nomination request under the good faith negotiation rule before November 1, 1986.

2. In general, the Commission is relying on existing reporting requirements and information collection provisions to implement the rules adopted in this proceeding. For example, producers that amend an existing contract must continue to file rate schedules under section 4 of the Natural Gas Act and § 154.92 (requiring independent producers to maintain rate schedules on file with the Commission); and 154.94 (requiring rate schedule filings with the Commission before a change in rate is effective) of the Commission's regulations. In addition, the limited exemption from filing requirements applicable to small producers under § 157.40 of the Commission's regulations remains applicable. In contrast, the Commission does establish a new filing requirement for producers that are granted certificates of public convenience and necessity to sell gas for resale in interstate commerce under new § 157.301 of the Commission's regulations. Under this filing requirement, producers must file an annual report with respect to any sales under that certificate initiated during the previous calendar year. The producer is only required to report each sales arrangement once. This report would detail, among other information: (1) The new and former purchaser and the terms of sale of gas sold under the blanket certificate authority of new § 157.301; and (2) the total estimated annual sales volumes of gas sold under the blanket certificate authority of that section. In addition, the rate filing requirements of §§ 154.92 and 154.94 of the Commission's regulations are waived for sales under a certificate granted under new § 157.301 of the Commission's regulations.

The information collection provisions in this rule are being submitted to the Office of Management and Budget (OMB) for its approval under the Paperwork Reduction Act [301] and OMB's implementing regulations.[302] Interested persons can obtain information on these information collection provisions by contacting the Federal Energy Regulatory Commission, 825 North Capitol Street, NE., Washington, DC 20426 (Attention: Ellen Brown (202) 357-8272). Comments on the information collection provisions can be sent to the Office of Informa-

[301] 44 U.S.C. 3501-3520 (1982).

[302] 5 CFR 1320 (1986).

tion and Regulatory Affairs of OMB, New Executive Office Building, Washington, DC 20503 (Attention: Desk Officer of the Federal Energy Regulatory Commission). List of Subjects:

18 C F R Part 154

Alaska, Natural gas, Pipelines, Reporting and recordkeeping requirements.

18 C F R Part 157

Administrative practice and procedure, Natural gas, Reporting and recordkeeping requirements.

18 C F R Part 270

Natural gas, Price controls, Reporting and recordkeeping requirements.

18 C F R Part 271

Continental shelf, Natural gas, Price controls, Reporting and recordkeeping requirements.

18 C F R Part 284

Continental shelf, Natural gas, Reporting and recordkeeping requirements.

In consideration of the foregoing, the Commission is amending Part 154, 157, 270, 271 and 284. Title 18, Code of Federal Regulations, as set forth below.

By the Commission.

KENNETH F. PLUMB,
Secretary.

APPENDIX A

COMMENTS FILED IN DOCKET NO. RM86-3-000

Note.—The following appendix will not appear in the Code of Federal Regulations.

City of Albion, Nebraska
City of Alliance, Nebraska

*† American Gas Association
American Farm Bureau Federation
* American Paper Institute, Inc.
*† American Public Gas Association
*† Amoco Production Company
ANR Pipeline Company
Applied Resources International, Inc.
*† ARCO Oil and Gas Company
Arkansas Public Services Commission
*† Associated Gas Distributors
Association of Texas Intrastate Natural Gas Pipelines
Baltimore Gas and Electric Company
Bass Enterprises Production Company
† California Public Utilities Commission
City of Chadron, Nebraska
† Chemical Manufacturers Association
Chevron U.S.A.
*† Cities Services Oil and Gas Corporation
† Citizen/Labor Energy Coalition
Citizens Energy Corporation
City Gas Company, et al.
Columbia Gas Distribution Companies
† Columbia Gas Transmission Corporation
Consolidated Edison Company of New York, Inc.
Consumer Advocate Division of Public Service
  Commission of West Virginia
Consumers Power Company and Michigan Gas Storage
  Company
James L. Coosby, The Hobby House
Council of Energy Resource Tribes

Council of Industrial Boiler Owners
City of Cozad, Nebraska
Davis Gas Processing, Inc.
* Delhi Gas Pipeline Corporation
Donaldson, Lufkin & Jenrette
Dorchester Hugoton Ltd.
*† E.I. Dupont de Nemours and Company
El Paso Natural Gas Company
Elizabethtown Gas Company
*† Department of Energy
Hon. James Exon, and Hon. Edward Zonrinsky
*† Exxon Corporation
† Fertilizer Institute
*† Florida Cities
Florida Gas Transmission Company
City of Gering, Nebraska
Hastings Utilities
Hecks Discount Stores
City of Henderson
Hewit & Dougherty and Dougherty Properties
City of Holdredge, Nebraska
Illinois Commerce Commission
City of Imperial, Nebraska
Independent Petroleum Association of Mountain States
Indiana Manufacturers Association, Inc.
*† Indicated Producers
†* Interstate Natural Gas Association of America
Interstate Oil Compact Commission
Interstate Power Company
Iowa Gas Company
† Iowa State Commerce Commission
Jicarilla Apache Tribe
† Department of Justice
Kaneb Operating Company, Ltd.
Kansas Power & Light Company
Hon. Nancy Landon Kassebaum
City of Kimball, Nebraska
† KN Energy Inc.

Laclede Gas Company
City of Lexington, Nebraska
† Hon. Jim Ross Lightfoot
Lone Star Gas Company
† State of Louisiana
Louisiana Association of Business and Industry
Louisiana Chemical Association
*† Maryland Peoples Counsel and National Association of State Utility Consumer Advocates
* Memphis Light Gas and Water Division of City of Memphis, Tennessee
MESA Petroleum Company
* State of Michigan and Michigan Public Service Commission
* Michigan Consolidated Gas Company
Michigan Manufacturers Association
Mid Continent Oil and Gas Association
Midwest Energy Inc.
Minnesota Department of Public Service
* Minnesota Department of Public Utilities, Energy Issues Intervention Office
Mississippi Manufacturers Association
Missouri Public Service Commission
† Mobil Oil Corporation
Montana Petroleum Association
* Montana Public Service Commission
National Association of Manufacturers
National Association of Wheat Growers
National Cattlemen's Association
National Council of State Garden Clubs, Inc.
National Fuel Gas Distribution Corporation
National Grange
*† Natural Gas Pipeline Company of America
*† Natural Gas Supply Association
New England Conference of Public Utilities Commissioners, Inc.
State of New Mexico
City of New York Housing Authority

† Northern Distributor Group
† Northern Illinois Gas Company
Northern Indiana Public Service Company
*† Northern Natural Gas Company
† Northwest Central Pipeline Corporation and the William Companies
Northwest Pipeline
City of Ogallala, Nebraska
State of Ohio, Office of Consumer Counsel
Ohio Farm Bureau Federation, Inc.
Oklahoma Corporation Commission
Oklahoma Kansas Division, Mid-Continent Oil and Gas Association
Hon. Michael G. Oxley, Hon. William E. Dannemeyer, Hon. Dan Schaeffer, Hon. Bob Whittaker, Hon. Jack Fields, and Hon. James T. Broyhill
Pacific Gas and Electric Company
* Panhandle Eastern Pipe Line Company
Pennsylvania Office of Consumer Advocate
Pennzoil Company and Pennzoil Producing Company
*† Peoples Gas Light & Coke Company and North Shore Gas Company
Peoples Gas System Inc.
Petrochemical Energy Group
Piedmont Natural Gas Company, Inc.
† Plains Petroleum Company
Pogo Producing Company
James D. Price, Mississippi House of Representatives
*† Process Gas Consumers Group and Industrial Group and American Iron and Steel Institute
Public Service Commission of Commonwealth of Kentucky
† Public Service Commission of District of Columbia
*† Public Service Commission of New York
Public Service Commission of West Virginia
Public Service Company of Colorado
Public Service Electric and Gas Company
Public Utilities Commission of Ohio

* Public Utilities Commission of Rhode Island
† Questar Corporation
* Rochester Gas and Electric Corporation
San Diego Gas and Electric Company
City of Scottsboro, Nebraska
† Shell Offshore, Inc. and Shell Western E & P Inc.
Ronald C. Shows, Mississippi State Senate
City of Sidney, Nebraska
South Dakota Public Utilities Commission
Southern California Edison Company
*† Southern California Gas Company
* Southern Natural Gas Company
Southern States Cooperative Inc.
Southwest Gas Corporation
Southwest Regional Energy Council
Sun Exploration and Production Company
† Taylor Energy Company
*† Tennessee Gas Pipeline Company
Tenngasco Corporation
† Texaco Inc.
* Texas Eastern Transmission Corporation
* Texas Gas Transmission Corporation
Texas Independent Producers and Royalty Owners Association
Texas Intrastate Natural Gas Pipelines
Texas Railroad Commission
*† Transcontinental Gas Pipe Line Corporation
* Transwestern Pipeline Company and Florida Gas Transmission Company
Union Texas Petroleum
*† United Distribution Companies
Virginia Agribusiness Council
William D. Watson, Esq., Holmes Roberts & Owen
West Texas Gas Inc.
West Virginia Highway Users Conference
West Virginia Manufacturers Association
Western Gas Interstate Company
† Governor Mark White of Texas

Williston Basin Interstate Pipeline Company
Wisconsin Public Service Commission
Wisconsin-Southern Gas Company Inc.
Wyoming Public Service Commission

* Submitted reply comments.

† Participated in public conference.

APPENDIX B

FILINGS SUBMITTED FOR ORDER NO. 436 BLANKET CERTIFICATES

Note.—The following appendix will not appear in the Code of Federal Regulations.

Company name	Docket No.	Date filed	Order issued
1. Valley Gas Transmission, Inc.	CP86-171	11/1/85	11/29/85.
2. Gas Gathering Corp.	CP86-129	11/1/85	12/5/85.
3. Mid Louisiana Co.	CP86-214	11/26/85	2/11/86.
4. Columbia Gulf Transmission Co.*	CP86-239	12/13/85	2/25/86.
5. Columbia Gas Transmission Corp.*	CP86-240	12/13/85	2/28/86.
6. Ozark Gas Transmission System	CP86-250	12/24/85	Pending.
7. Gas Transport, Inc.*	CP86-291	1/24/86	Do.
8. Valero Interstate Transmission Co.	CP86-300	1/30/86	Do.
9. Consolidated Natural Gas Co.	CP86-311	2/10/86	Do.
10. Erie Pipeline System (ANR Pipeline Operator)	CP86-330	2/14/86	Do.
11. Transylvania Pipeline Co., Inc. (Transco affiliate)	CP86-334	2/14/86	Do.
12. Seagull Interstate Corp.	CP86-364	3/7/86	Do.
13. Texas Eastern Gas Transmission Co.	CP86-379	3/13/86	Do.
14. Superior Offshore Pipeline Co.	CP86-387	3/17/86	Do.
15. Northern Border Pipeline Co.	CP86-395	3/19/86	Do.
16. Transco Offshore Gathering Co.	CP86-397	3/20/86	Do.
17. Transcontinental Gas Pipeline Corp.	CP86-405	3/28/86	Do.
18. Northern Natural Gas Co.	CP86-435	4/11/86	Do.
19. Washtenaw Pipeline Co.	CP86-445	4/15/86	Do.
20. Standard Gas Marketing Co.	CP86-449	4/16/86	Do.
21. Transco Gas Services Inc.	CP86-452	4/17/86	Do.
22. Moraine Pipeline Co.	CP86-492	5/12/86	Do

23. Mantaray Transmission Co.	CP86-507	5/21/86	Do.
24. Texas Gas Transmission Corp.	CP86-521	5/30/86	Do.
25. Sabine Pipe Line Co.	CP86-522	5/30/86	Do.
26. Iroquois Gas Transmission Co.	CP86-523	5/30/86	Do.
27. Kentucky-West Virginia Gas Co.	CP86-526	5/30/86	Do.
28. Tennessee Gas Pipeline Co.	CP86-534	6/3/86	Do.

* Company filed November 1, 1985, statement of intent to provide non-discriminatory transportation.

ONGOING SETTLEMENT NEGOTIATIONS WHICH INVOLVE NO. 436

Company name	Docket number
1. Northern Natural Gas Company	RP85-206
2. Texas Gas Transmission Company	
3. ANR Pipeline Company	
4. Natural Gas Pipeline Co. of America	
5. Panhandle Eastern Pipe Line Company	RP85-194
6. Tennessee Gas Pipeline Co.	RP86-119

Note.—Tariff filings submitted 1/31/86 by El Paso Natural Gas Company; a settlement (Docket No. RP85-175) and revised tariffs (CP86-276) filed by Transwestern Gas Company only lay the Foundation upon which these companies may return and file formal Order 436 blanket certificate applications. Recent filings by intrastate companies owned by Oklahoma Natural Gas Pipeline are also considered preliminary filings not formal Order 436 applications.

37 FERC ¶ 61,252

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Docket Nos. RM86-3-003 through -068

CEILING PRICES: OLD GAS PRICING STRUCTURE

ORDER NO. 451-A

ORDER GRANTING REHEARING IN PART, DENYING REHEARING IN PART, AND CLARIFYING FINAL RULE

(Issued December 15, 1986)

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UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Martha O. Hesse, Chairman; Anthony G. Sousa, Charles G. Stalon, Charles A. Trabandt and C. M. Naeve.

Docket Nos. RM 86-3-003 through -068

CEILING PRICES: OLD GAS PRICING STRUCTURE

ORDER NO. 451-A

ORDER GRANTING REHEARING IN PART, DENYING REHEARING IN PART, AND CLARIFYING FINAL RULE

(Issued December 15, 1986)

I. INTRODUCTION

On June 6, 1986, the Commission issued Order No. 451 modifying the price structure of old natural gas pursuant to its authority under sections 104(b)(2) and 106(c) of the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. §§ 3301-3432 (1982), and adopting regulations governing implementation of the revised price structure. 51 Fed. Reg. 22,168 (June 18, 1986). The order became effective on July 18, 1986.[1] Numerous requests

for rehearing have been filed challenging virtually all aspects of Order No. 451. This Order No. 451-A denies rehearing of Order No. 451 for the most part. However, certain modifications to the implementing procedures are adopted and various provisions of the rule are clarified.

II. BACKGROUND

In November 1985, the Secretary of Energy, acting pursuant to section 403 of the Department of Energy Organization Act,[2] issued and transmitted to this Commission for its consideration and action a proposed rule to reform the pricing structure for certain categories of natural gas subject to ceiling prices under sections 104 and 106 of the NGPA. According to the Department of Energy (DOE), the separately vintaged pricing system for old natural gas established by the NGPA distorted price signals in the natural gas market, raised consumer prices above market-clearing levels, inhibited efficient production of least-cost supplies, and would, unless modified, result in the loss of some 11 trillion cubic feet of old gas reserves. DOE argued that overall prices for gas had not fallen to market-clearing levels, despite the current surplus of available supplies, due to the cushion provided by old gas ceiling prices and that as a result consumers had not realized the full benefit of market competition. DOE also argued that the NGPA's old gas pricing system failed to assign a reasonable share of the replacement cost of new gas supplies to purchasers of old gas and concluded that the old gas ceiling prices should be corrected to take into account current competi-

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[1] On July 18, 1986, the Commission stayed the effectiveness of Order No. 451 until July 30, 1986, at the request of the United States Court of Appeals for the Eighth Circuit. 35 FERC ¶ 61,067. The stay was granted in order to allow additional time for the court to consider a petition filed on July 1, 1986, by KN Energy, Inc. requesting issuance of a writ of prohibition or, alternatively, a writ of mandamus directing the Commission to vacate Order No. 451. On August 19, 1986, the Court denied KN's petition. *In re KN Energy, Inc.*, No. 86-1806 (8th Cir. Aug. 19, 1986).

[2] 42 U.S.C. § 7173 (1982).

tion in natural gas markets. DOE therefore proposed that the Commission exercise its authority under sections 104(b)(2) and 106(c) of the NGPA to eliminate vintage-based pricing of old gas by establishing a uniform ceiling price equal to the highest current ceiling price for old gas, that being the post-1974 vintage, with a price of $2.57 per MMBtu as of June 1986.[3]

DOE also proposed a "good faith negotiation rule" under which "first sellers"[4] would be given a one-time right to request their purchasers to nominate a price the purchaser was willing to pay, up to the new ceiling. If the purchaser nominated the ceiling price, the sale would continue at the new ceiling price. If the purchaser nominated a lower price, the seller could accept the price and continue sales at that price. Alternatively, the seller could reject the nominated price, in which case sales would continue at the existing price, but the seller would have the right at any time to sell the gas to another purchaser at a higher price provided the sale was for a term of at least two years. In that event, the seller would be released from any further obligation in law or contract to the existing purchaser upon 30-days notice. DOE also proposed that the Commission exercise its authority under NGPA section 107(b) by establishing higher incentive prices for production enhancement gas and creating certain new categories of gas eligible for the higher incentive prices.

Notice of the proposed rule was issued in the *Federal Register* on November 25, 1985 (50 Fed. Reg. 48,-

[3] Under DOE's proposal the new ceiling price would continue to be adjusted for inflation each month. First sellers would be entitled to claim the new ceiling price only if authorized by contract. However, since approximately 90 percent of old gas is sold under contracts containing sufficient authorization in the form of indefinite price escalation clauses, most old gas producers would be entitled to claim the new ceiling price.

[4] *See* NGPA section 2(21), 15 U.S.C. § 3302(21) (1982).

540). On December 20, 1985, the Commission issued a notice establishing a schedule for public comments on the proposed rule.[5] The Commission requested comments by interested parties concerning the scope of Commission authority to implement the proposal, including the elements of the just and reasonable rate standard applicable to old gas prices, the operation of indefinite price escalation clauses in old gas contracts, the relationship of the proposed rule to the Commission's block billing proposal in Docket No. RM85-1-000 and the likely response of the market in developing old gas supplies. On February 26, 1986, the Commission issued a notice providing for the filing of reply comments and scheduling a two-day public conference for discussion of issues involved in the proposed rule.[6] Initial comments were filed by February 25, 1986, and reply comments were filed by March 27, 1986. Over 160 initial comments and over 40 reply comments were received from numerous producers, pipelines, and gas distribution companies, as well as DOE, the United States Department of Justice, consumer representatives, members of Congress, States, State regulatory agencies, Cities, trade and business associations, and individuals.

In Order No. 451, the Commission adopted DOE's old gas price proposal, establishing a new, alternative ceiling price of $2.57 per MMBtu for old gas subject to Commission jurisdiction under NGPA sections 104 and 106. The Commission also adopted a modified version of the good faith negotiation rule. The good faith negotiation rule proposed by DOE was modified by allowing purchasers, in response to price renegotiation requests of a first seller, to request price renegotiation of any gas sold under the contract placed on the bargaining table by the producer as well as all gas sold under other contracts with the same first seller which include any

[5] 50 Fed. Reg. 52,935 (Dec. 27, 1985).

[6] 50 Fed. Reg. 7,583 (Mar. 5, 1986).

old gas. Each party is allowed 60 days to respond to price nomination requests of the other party, and each party is given 30 days to respond to the other party's price nomination. If no agreement on repricing is reached, the producer may abandon sales to the purchaser and the purchaser may terminate its purchases. The effectiveness of the good faith negotiation rule was deferred until November 1, 1986, in order to enable both purchasers and first sellers to become familiar with its terms and to encourage contracting parties to enter into voluntary contract renegotiations in lieu of mandatory renegotiation under the good faith negotiation procedures.[7] Abandoning producers were granted blanket certificates of public convenience and necessity authorizing the sale of gas abandoned or released under the rule, and rate filing requirements were waived for such sales. DOE's proposals to require that any sale of abandoned gas be for a term of at least two years and at a price higher than that offered by the existing purchaser were not adopted. The Commission instead provided firm sales customers of interstate pipelines with a right of first refusal enabling them to purchase abandoned or released gas by agreeing to meet the terms offered by any potential third-party purchaser. Interstate pipelines which are not open-access transporters under Order No. 436 [8] were

[7] On July 17, 1986, the Commission issued an Interim Order on Rehearing to confirm that contract amendments may be made outside the good faith negotiation procedures. 36 FERC ¶ 61,058. The Commission has aslo delayed the date on which good faith negotiation may be initiated until December 18, 1986. 37 FERC ¶ 61,077.

[8] Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, Docket No. RM85-1-000, Order No. 436, 50 Fed. Reg. 42,408, 42,372 (Oct. 18, 1985), corrected at 50 Fed. Reg. 45,907 (Nov. 5, 1985); Order No. 436-A, 50 Fed. Reg. 52,217 (Dec. 23, 1985); Order No. 436-B, 51 Fed. Reg. 6398 (Feb. 24, 1986); Order No. 436-C, 51 Fed. Reg. 11,566 (April 4, 1986); Order No. 436-D, 51 Fed. Reg. 11,569 (April 4, 1986); Order No. 436-E, 51 Fed. Reg. 11,566 (April 4, 1986); appeals docket *sub nom.* Associated Gas Distributors *et al.* v. FERC, Nos. 85-1811 *et al.* (D.C. Cir.).

granted blanket transportation authorization and are deemed to have agreed to transport abandoned or released gas to their existing customers or to interconnected pipelines. Action on DOE's incentive price proposal was deferred pending further Commission review.

III. REQUESTS FOR REHEARING

The Commission received 62 requests for rehearing challenging virtually every aspect of Order No. 451. (*See* Appendix A.) Applicants seeking rehearing argue variously that in adopting the rule the Commission exceeded the scope of its authority, that even assuming sufficient authority, the rationales for the rule are inadequate or invalid, that various provisions of the rule are unlawful, that the rule is unbalanced in favor of particular categories of affected parties, and that various terms and provisions of the rule require clarification. The Commission has reviewed the arguments set forth in the rehearing requests and concludes they do not justify making any significant changes in the basic terms of the rule. However, the Commission agrees that certain modifications should be made, mostly involving the procedures of the good faith negotiation rule and transportation rates. The Commission also grants numerous requests for clarification of various terms and provisions of the rule.

IV. DISCUSSION OF REHEARING ISSUES

A. *Commission Authority*

In Order No. 451 the Commission acted to reform the price structure of old gas under the authority of sections 104(b)(2) and 106(c) of the NGPA and rejected arguments of various commenters that Congress' incorporation in the NGPA of the prices and price structure for old gas in effect prior to enactment of the NGPA deprived the Commission of authority to alter that structure under the authority of the Natural Gas Act (NGA).

The Commission concluded that the terms of sections 104 (b) (2) and 106 (e) are unambiguous and specifically authorize the Commission to modify the prices and price structure of old gas, subject only to the just and reasonable standard of the NGA.

Requests for Rehearing. Numerous rehearing applicants reiterate the arguments made in their comments that sections 104 (b) (2) and 106 (e) do not provide authority for the Commission's promulgation of a single maximum lawful price for all old gas, and the consequent elimination of the system of tiered prices based on the date the wells were drilled.[9] Applicants argue that Congress intended to leave old gas under the largely original-cost-based price ceilings in effect at the time of enactment of the NGPA in order to protect consumers from the effects of deregulation of new gas prices and prevent a financial windfall to producers of old gas, while at the same time stimulating addition of new reserves, and that the Commission's action in Order No. 451 is thus at odds with the basic purpose and design of the NGPA.

Applicants argue that the Commission's authority to increase old gas prices under sections 104 (b) (2) and 106 (e) is limited to applying the rate-making principles embodied in the last producer rate orders issued by the Federal Power Commission before enactment of the

[9] United Distribution Companies (UDC) at 15-37; American Public Gas Association (APGA) at 12-20; Maryland Peoples Counsel/National Association of State Utility Consumer Advocates (MPC NASUCA) at 6-13; KN Energy, Inc. (KN) at 13-17; Northern Natural Gas Company (Northern Natural) at 5-10; Florida Cities at 5-6; Public Service Commission of New York (N.Y. PSC) at 2-8; Public Service Commission of the District of Columbia (D.C. PSC) at 8-13; Interstate Natural Gas Association of America (INGAA) at 6-7; Michigan and the Michigan Public Service Commission (Michigan) at 2-5; Laclede Gas Company (Laclede) at 2-6.

NGPA, Opinion Nos. 770 and 770-A.[10] These orders modified a decision in the previous national rate order, Opinion No. 699-H,[11] to gradually eliminate vintaging, and re-established a vintaged-based price structure for old gas. Applicants argue, therefore, that the Commission now lacks authority to eliminate the system of vintage pricing adopted in Opinion No. 770 or to base old gas ceiling prices on cost methods different from those from which the old gas prices adopted in that proceeding were derived. UDC argues that the Commission had never adopted a purely replacement-cost-based rate for old flowing gas prior to enactment of the NGPA and that Congress, therefore, could not have intended to allow the use of this methodology to raise ceiling prices for old gas under the authority of section 104 (b) (2) of the NGPA.[12]

Several applicants argue that the United States Supreme Court's discussion of the NGPA in *Public Service Commission of New York v. Mid-Louisiana Gas Co.*[13] supports the conclusion that the Commission may increase old gas prices under the authority of sections 104 (b) (2) and 106 (e) only when traditional NGA principles would dictate a higher price, such as when costs have increased at a rate in excess of the statutory inflation adjustment.[14] UDC cites *Mid-Louisiana* for the proposition that the vintaged price structure for old gas became unalterable upon passage of the NGPA:

> The statute evinces careful thought about the extent to which producers of 'old gas'—the gas already dedicated to interstate commerce before passage of the

[10] 56 FPC 509 (1976) and 56 FPC 2698 (1976).

[11] 52 FPC 604 (1974).

[12] UDC at 17-20.

[13] 463 U.S. 319, 333-35 (1983).

[14] UDC at 31-33; MPC NASUCA at 11-12.

NGPA—would be able to enjoy incentive pricing. Section 104 of the statute directly incorporates part of the 'vintaging' pattern that previously existed under the NGA.[15]

Several applicants argue that the Commission's authority under sections 104(b)(2) and 106(c) is limited to granting "special relief" on a case-by-case basis, where the otherwise applicable ceiling prices are insufficient to allow producers to recover their production costs.[16] These applicants cite a Commission order terminating a proposed rulemaking on special relief regulations where sections 104(b)(2) and 106(c) were described as providing authority under the NGPA to continue granting special relief in accordance with procedures and standards developed under the NGA.[17] The PUC of California also cites *Interstate Natural Gas Association of America v. FERC*[18] for the proposition that Congress did not intend to permit the Commission to raise old gas prices across the board, but only on a case-by-case basis.[19]

Other applicants argue that because the new ceiling price is well above current market prices for natural gas, Order No. 451 constitutes *de facto* deregulation of old gas, in contravention of Congress' intent under the NGPA to leave old gas "forever regulated."[20] These

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[15] 463 U.S. at 334.

[16] D.C. PSC at 8-9; California Public Utilities Commission (Cal. PUC) at 15-17; Southern California Gas Company (SoCal) at 10-12.

[17] FERC Statutes and Regulations, Regulations Preambles (1982-1985), ¶ 30,565 at 30,928.

[18] 716 F.2d 1 (D.C. Cir. 1983), *cert. denied*, Exxon Corp. v. Interstate Natural Gas Assoc., 465 U.S. 1108 (1984).

[19] PUC of California at 16.

[20] Northern Natural at 11-13; Minnesota Department of Public Safety (Minnesota DPS) at 2-3; INGAA at 8-9; APGA at 16-17; Kansas Power & Light Company (KP&L) at 14-16; N.Y. PSC at 13-15.

applicants note that the Commission repeatedly asserted its goal of providing for "market-responsive prices" for old gas by means of the regulations promulgated in Order No. 451. They argue, however, that the Supreme Court has construed the NGA as prohibiting the Commission's reliance on prevailing prices in the marketplace to determine just and reasonable rates, citing *FPC v. Texaco, Inc.*[21]

Commission Response. The Commission recognizes that section 104(b)(1) of the NGPA was intended to directly incorporate the just and reasonable rates, and thus the cost-based prices according to vintage, in effect at the time of the NGPA's enactment. Further, the Commission agrees that Congress considered this provision for old gas prices to be a significant feature of the NGPA's design, intended to mitigate the effects on consumers of allowing higher prices for new gas. The Commission expressed the same rationale for its decision to retain vintage-based rates in Opinion No. 770. However, the applicants have not cited, nor has the Commission found, any legislative history whatsoever on section 104(b)(2),[22] or the virtually identical sections 106(c) and 109(b)(2), that raises any doubt about its plain meaning. If Congress had intended old gas prices to be forever subject to the ceilings in effect when the NGPA was enacted, subject only to the statutory inflation adjustment, sections 104(b)(2) and 106(c) would not have been included in the NGPA. The authority granted to the Commission under these provisions to increase old gas prices above the otherwise applicable maximum lawful prices is too clear to admit any doubt. By inclusion of these provisions, Congress authorized the Commission to review and revise old gas prices in light of current conditions. The *only* limitations imposed by section 104(b)(2) on

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[21] 417 U.S. 380 at 397-99 (1978).

[22] 15 U.S.C. § 3314(b)(2) (1982).

the Commission's authority to restructure old gas prices is that such prices must be just and reasonable within the meaning of the Natural Gas Act and may not be lower than the ceiling prices established under section 104(b)(1).

Nothing in section 104(b)(2) or the NGPA's legislative history supports the applicants' argument that Congress intended to limit the scope of the Commission's discretion under the NGA to utilize whatever methodology it chooses to establish rates for old gas, so long as the end result is just and reasonable. The record of the debates on the NGPA demonstrates that Congress was clearly aware of the broad scope of that discretion. Senator Abourezk, for example, stated during the Senate's debate on the NGPA on September 19, 1978:

> In addition, it is critical to point out that the law [NGA] does not require that the price set by the FERC be cost-based, except that, in the absence of full cost justification, the FERC must show the tangible benefits to consumers. This is the "end result test" established in FPC against Hope Natural Gas Co. . . .
>
> Nothing prevents FERC setting the rate at whatever level is necessary actually to elicit new supply. . . .[23]

Senator Kennedy also stated, later the same day:

> I want to remind Senators that the means of increasing production is already available in the form of the Federal Energy Regulatory Commission Authority. Sufficient authority already exists to establish prices which will being forth gas at a "just and reasonable" price and to vary that price according to conditions.[24]

[23] 124 Cong. Rec. 30,018 (Sept. 19, 1978).

[24] 124 Cong. Rec. 30,023 (Sept. 19, 1978).

However, except for the proscription against reducing old gas prices from the ceilings otherwise applicable under sections 104(b)(1) and 106(b), Congress did not limit the Commission's authority to establish old gas prices under the just and reasonable standard of the NGA.[25]

The statements by the Supreme Court in *Public Service Commission of New York v. Mid-Louisiana Gas Co., supra*, do not support the applicants' assertions that the Commission lacks authority under section 104(b)(2) to eliminate vintage pricing for old gas. In *Mid-Louisiana* the Court held that interstate pipelines that owned gas wells were entitled to have their intra-corporate transfers of gas treated as "first sales" and thus be subject to the pricing provisions of the NGPA. The statement from *Mid-Louisiana*, quoted above, is part of a general description of the NGPA's pricing provisions and not a holding on the scope of the Commission's authority. The Court accurately described section 104(b)(1) as directly incorporating the existing pattern of vintaged prices. However, the Court also referred to section 104(b)(2): "[T]he statute recognizes that the ceiling [under section 104(b)(1)] may be too *low* and authorizes the Commission to raise it whenever traditional NGA principles

[25] While the Commission has asserted that section 104(b)(2), 106(c), and 109(b)(2) provide authority to grant special relief in the form of higher prices for old gas from certain wells or leases, it has never suggested that the authority granted by these provisions is limited to granting relief on a case-by-case basis. FERC Statutes and Regulations, Regulations Preambles (1982-1985) ¶ 30,565. Nor is this authority so limited by the decision of the United States Court of Appeals for the D.C. Circuit in Interstate Natural Gas Association of America v. FERC, *supra*, that the Commission lacked authority under the NGPA to allow higher prices for natural gas by altering the standard for measuring its Btu content. Section 104(b)(2) specifies circumstances where the Commission is authorized to increase gas prices, without limiting the exercise of that authority to individual cases.

would dictate a higher price." [26] As discussed more fully in succeeding sections, the Commission in this proceeding has revised the old gas price structure on the basis of reasonable and previously approved principles of regulation fully consistent with the just and reasonable standard of the NGA and the Court's comments in *Mid-Louisiana.*

While the Commission recognizes the benefits of market-responsive prices in a competitive environment, it does not in this proceeding rely exclusively on market forces to establish just and reasonable prices. Thus, the price of old gas has not been deregulated *de facto* or otherwise. Order No. 451 allows for sales of old gas *to be* negotiated in light of current market conditions, but with a protective ceiling price based on long-term replacement costs. Because current market prices for natural gas are *generally* below the alternative ceiling price established for old gas by Order No. 451, the good faith negotiation procedures are expected to result in prices for old gas that are market-responsive. However, old gas prices can respond to market forces only within the just and reasonable ceiling price, and thus remain regulated.

The Supreme Court's decisions in the *Mobile* and *Sierra* cases [27] established the doctrine, preserved in this proceeding, that the agreement of the parties sets the lawful rate for a utility service under the NGA, so long as the contract rate does not exceed the rate found just and reasonable by the Commission. Thus, market forces will operate within the regulated ceiling price for old gas under Order No. 451 as under any other rate ceiling established by the Commission under the NGA, or under NGPA ceiling prices for other categories of gas.

[26] 319 U.S. at 333 (emphasis in original).

[27] United Gas Pipe Line Co. v. Mobile Gas Corp., 350 U.S. 332 (1956); FPC v. Sierra Pacific Power Co., 350 U.S. 348 (1956).

B. *Old Gas Price Structure*

In the final rule the Commission determined that the record in this proceeding demonstrated that the old gas price structure was a principal source of market distortion, that it caused producers to abandon prematurely easily accessible supplies, and caused consumers to react to misleading market signals. The Commission concluded that the old gas price structure was a central factor contributing to current market anomalies, characterized by falling wellhead prices, unresponsive citygate prices, fuel switching, loss of loads, and excess production and transmission capacity. The Commission therefore determined that the old gas price structure was unjust and unreasonable and should be abolished.

In adopting the final rule, the Commission confirmed the view that the then-existing old gas price structure was outmoded, and characterized by distortions, inequities, inefficiencies and disincentives, that demanded reform.[28] Prior to issuance of Order No. 451, it had been nine years since the last national ratemaking was completed. Thus, the economic data and information concerning replacement costs, commodity values, and other factors which were considered by the Commission in formulating the old gas prices had been overtaken by events, which include the current market realities of excess deliverability and declining investment in exploration and development and the imperative need for national energy self-sufficiency. The former system of vintaged rates for old gas failed to accurately reflect the cost and market

[28] The former price structure for old gas consisted of 15 separate categories based for the most part on the vintage-based price categories and related prices established by the Commission in national rate proceedings in Opinion Nos. 749 (pre-1973 gas) (54 FPC 3090 (1975)) and 770-A (post-1972 gas) (56 FPC 2698 (1976)) and which were in effect as of April 1977. These rates were incorporated in the NGPA, subject to increase by the Commission to a new maximum lawful price, if just and reasonable within the Natural Gas Act.

value of certain categories of old gas; thus, it discouraged production of old gas reserves, reflected an unwarranted disparity between old and new gas prices, was unnecessarily complex, and caused distortion in the market because of the unequal access of pipelines and distributors to various categories of old gas supplies.

The Commission found most persuasive studies showing that if current old gas prices were held at their present levels, approximately 11 Tcf of old gas reserves would not be produced. The 11 Tcf of old gas reserves not produced as a result of vintaging would have been replaced by higher-priced energy supplies. In part these incremental supply requirements would be met by foreign imports of both oil and gas and the nation's energy security would thereby be compromised and its trade balance weakened. Regardless of the source of the incremental supplies, however, the nation's energy users would be required to pay more for these incremental supplies than would be necessary.

The Commission utilized as one basis for judging the just and reasonableness of the NGPA old gas prices, the four criteria employed by the Commission in its notice requesting supplemental comments in Docket No. RM85-1-000 (Part D), issued on October 9, 1985.[29] Under these standards, a just and reasonable rate must (1) permit efficiency in the production and consumption of natural gas, (2) permit fair competition, (3) prevent wasteful depletion, and (4) respond to changing conditions in the industry. The former vintaged old gas prices failed to meet these standards and were therefore found no longer just and reasonable.

Requests for Rehearing. A number of rehearing applicants challenge the Commission's findings concerning the price structure of old gas.[30] A large number of these

[29] 50 Fed. Reg. 42,372 (Oct. 18, 1985).

[30] Associated Gas Distributors (AGD) at 8; The Kansas Power and Light Company, Kansas Public Service Company, and Missouri Public Service Company (KP&L *et al*) at 26-27; (MPC NASUCA at 24-26; Northern Natural at 9; D.C. PSC at 4; Northern Illinois Gas Company (NI-Gas) at 9; Interstate Power Company at 4; KN at 15-17; Northwest Central Pipeline Corporation (Northwest Central) at 23-24; Midwest Energy Inc. (Midwest) at 4-5.

parties continue to argue that the major cause of distortion in the natural gas market is the rigidity of existing contract relationships, not vintaging. They also argue that the Commission appears at one time to have shared this view—notably in Order No. 436—and that the Commission's "change" of position is inconsistent.[31] In this vein, Northwest Central asserts that the Commission acted arbitrarily "in failing to resolve issues involving new gas with above-market prices and high take-or-pay contracts." [32] Putting it another way, KP&L asserts that the Commission's finding that the vintaging pricing structure is responsible for current market disorders was arbitrary.[33] NI-Gas appears to acknowledge as beneficial the fact that Order No. 451 addresses the causes of distortion (vintage rates), but argues that the rule provides "no symptomatic relief" [34] from contracts.

MPC/NASUCA renew assertions that the competitive advantages associated with disproportionate access to the old gas vintages no longer exist. MPC/NASUCA confirm that what they refer to are the bidding wars of the 1978-1981 period of relative supply scarcity. During that period, pipelines with relatively larger cushions of old gas vintages were able to outbid their competitors, not on the basis of efficiency of operation and management, but solely based on the amount of "old" gas they could roll-in without adversely affecting their weighted average cost

[31] AGD at 8; KP&L *et al.* at 26-27.

[32] Northwest Central at 27.

[33] KP&L *et al.* at 27.

[34] NI-Gas at 9.

of gas (WACOG) vis-a-vis other pipelines.[35] Since all WACOG's are now above market-clearing levels, MPC/NASUCA insist that the distorting effects of what they admit are "artificially low prices" [36] have been expended.

KN aserts that because Congress incorporated "part of the vintaging pattern" into the NGPA, the Commission no longer has the discretion to eliminate vintaging, even if it did have that discretion under the NGA. KN claims that the Commission's staff "acknowledged the fact that the Commission has no clear legal authority to eliminate vintaging," [37] in the staff analysis attached to the 1982 Notice of Inquiry in Docket No. RM82-26-000.

Finally, a number of applicants take issue with the Commission's perception that the old gas "cushions" enjoyed by some pipelines are the result of historical accident. Northern Natural, for example, asserts that the cushions "in most cases" reflect years of prudent and effective management.[38]

Commission Response. Applicants have generally raised arguments previously made in comments and reply comments to the final rule. The Commission has already considered and disposed of these arguments. The Commission finds nothing new that would impel it to change its determination that the old gas vintage price structure had become unjust and unreasonable and should therefore be replaced.

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[35] *See* Order No. 451, 51 Fed. Reg. at 22,181 and n.110.

[36] MPC/NASUCA at 25.

[37] KN at 13-17 *citing* Staff Analysis, Impact of the NGPA on Current and Projected Natural Gas Markets (Notice of Inquiry), IV FERC Stats. & Regs. ¶ 35,512 at 35,573-74 (1982). KN's assertions related to the Commission's authority to eliminate vintaging has already been addressed in Part IV. A., *supra*.

[38] Northern Natural at 9. *See also* Interstate Power Company at 4; Midwest at 4-5.

The Commission reaffirms that the former ceiling price structure for old gas is the *primary* cause of continuing price distortions to consumers in natural gas markets. This is not to say it is the *only* cause.

The former old gas prices distorted consuming patterns in two ways. First, consumers supplied by pipelines with access to large quantities of the below market-priced vintages are misled into the false belief that they can continue to buy incremental units of gas for less than the true market price. These pipelines are then required to meet their customers' demands by bidding up the price of new gas. Second, consumers supplied by pipelines with limited access to low-priced categories of gas are required to pay higher than necessary prices because these pipelines have to purchase incremental supplies whose price has been distorted by pipelines who had large quantities of below market-priced gas and who have bid up the price of new gas to meet their own customers' demands. Consequently, customers of high cost pipelines have attempted to switch to either less expensive gas supplies or alternative fuels when able, thus causing their original pipeline supplier to lose load and attempt to shift costs to those customers without the ability to switch supplies or fuels. Likewise, customers supplied by pipelines with access to large quantities of the below market-priced vintages will not consider the use of alternative supplies even though those supplies may be cheaper when the incremental supplies' marginal cost is compared with the marginal cost being paid by their pipeline supplier.

These same price signal distortions also distort producers' exploration, development and production decisions. Specifically, producers selling new supplies find that pipelines endowed with a below-market cushion of old gas are willing to pay otherwise above-market prices in order to secure new supplies to meet their growing demand. This in turn encourages the development of more new high-cost marginal supplies at costs which ex-

ceed that which an undistorted market would be willing to pay, while producers of below-market-priced old gas vintages are discouraged from making investments needed to maximize production of easily available production from existing fields. Correcting these distortions which arise primarily from the old gas price structure was the central purpose of the notice of inquiry in Docket No. RM82-26-000,[39] was integral to the proposal in Docket No. RM85-1-000,[40] and was finally accomplished in Order No. 451.[41] Notwithstanding the assertions of certain applicants to the contrary, the Commission has neither changed positions nor been inconsistent. The elimination of vintaging, coupled with the good faith negotiation process, will help bring economic rationality and more competition to the natural gas markets and will provide a framework for overhauling rigid contract structures. In the more economically rational market-responsive environment created by Order No. 451, lower cost gas will be produced first, and higher cost gas produced only later, as needed.

Applicant NI-Gas is correct, in at least acknowledging that Order No. 451 addresses the root causes of market

[39] *See* Order No. 451, 51 Fed. Reg. at 22,181 n.105 (June 18, 1986).

[40] *Id.* at 22,182 ("[V]intaging is the major cause of the market distortions identified by the Commission in Docket No. RM85-1-000. . . .").

[41] AGD argues that in Order No. 436, the Commission attributed market disorders to rigid contracts, but in Order No. 451 attributed them to the vintage pricing system. Since Order No. 436's "principal mission" was market analysis, the Order No. 436 approach should have been adopted according to AGD. Yet the approach of Part D of Order No. 436 dealt by indirection with the problem the Commission addressed directly in Order No. 451. Thus there was no divergence from the "mission" of Order No. 436 as alleged by petitioner AGD. *See* AGD at 8. Both orders have a role to play in developing a more market-responsive industry framework. *See also* part V. B. *infra.*

distortion by collapsing the vintage rates, than are those applicants such as AGD who insist that the contractual "symptoms" of vintaging are the root problem. Treating the cause of an ailment will provide relief from the symptoms in due course. The Commission cannot concur that Order No. 451, by treating vintaging as a root cause, provides no symptomatic relief whatsoever for these contract problems. Under the good faith negotiation process established by the rule,[42] pipelines as well as producers may effect the renegotiation of many "problem" contracts entered into in the context of the old vintage structure. Moreover, Order No. 451 provides room for and encourages negotiations outside of the good faith negotiation process.[43] Thus Order No. 451 addresses both the primary cause and the symptoms of the existing market distortions. AGD, KP&L, and Northwest Central's assertions of inconsistency with, or departure from, Order No. 436 and the Notice of Inquiry are therefore without merit.

The Commission must similarly reject again the contentions of those petitioners such as MPC/NASUCA, who assert that the distortions engendered by the vintage structure no longer exist. MPC/NASUCA admit the old vintages were "artificially low" and had a distorting effect in the past.[44] MPC/NASUCA confirm the Commission's assumption in Order No. 451 that the distortion they refer to is a narrower concept than the Commission's, because it is limited to the immediate effects of the bidding wars of the 1978-1981 period of relative supply scarcity. During that period, pipelines were able

[42] Order Nos. 451, 51 Fed. Reg. 22,204-09 (June 18, 1986).

[43] *See also* Interim Order On Rehearing, issued July 17, 1986, Docket No. RM86-3-002, 36 FERC ¶ 61,058, designed to encourage voluntary renegotiation by clearly permitting contract amendments, if the parties desire, without loss of rights under the good faith negotiation rule.

[44] MPC/NASUCA at 25.

to bid-up new supplies to distorted, above-market levels by "rolling-in" the old gas with the new. In response to applicant MPC/NASUCA's insistence that the distorting affect of the "artificially low" vintage has dissipated, the record in this proceeding demonstrates the continuing correlation betwen various pipelines' access to cushion gas and the pipelines' WACOGs. Unless the vintage structure is corrected now, during a transient period of opportunity when bidding-up of new gas and ability to roll-in high price new supplies with old gas has temporarily subsided, the cycle could repeat itself. Pipelines with low WACOGs have an inherently distorting impact on the market, because they need not contract for new gas supplies based on any fair measure of competitive equality. Far from being dissipated, the distortions inherent in having the old vintages priced "artificially low" thus persist today, and would be renewed to full vigor as the gas bubble dissipates and supplies tighten in the years ahead. The current decline in rig counts [45] testifies to the danger of the full-blown reappearance of these now quiescent distortions.

Current market realities make it plain that there will not likely be extensive new investment in order to add additional high cost supplies at this time. The most efficient way of adding incremental supplies is to stimulate production of low-cost gas, which represents an assured and reliable supply available at the lowest reasonable cost. Therefore the Commission took action to provide the incentive to produce these reliable low cost supplies by establishing the new just and reasonable rate for such gas in the final rule.

In addition, gas from wells with low price ceilings may be prematurely abandoned and resources lost absent the elimination of below-market price ceilings. The

[45] Hughes Rig Count as of Nov. 11, 1985 was 1,895; as of Nov. 10, 1986 it declined to 874. See Oil & Gas Journal, Week of Nov. 17, 1986, at 76.

sooner these distortions are eliminated, and a more market-responsive environment allowed to develop under the negotiation initiatives encouraged by Order No. 451, the better. Otherwise, some resources will remain under-produced, or even permanently lost, while other, marginal resources are developed at higher cost and before they are needed. Consumers on deep cushion pipelines will continue to be misled as to the true cost of replacing the gas they consume, while consumers on pipelines less well-endowed will continue to pay higher prices for their supplies.

KN's assertion that the staff analysis attached to the 1982 Notice of Inquiry in Docket No. RM82-26-000 "acknowledged the fact that the Commission has no clear legal authority to eliminate vintaging" is puzzling, when actually the staff concluded that "the Commission probably has the legal authority to eliminate vintaging, if such elimination is found to be just and reasonable, by setting a single just and reasonable rate for all gas currently vintaged." [46] The analysis goes on to note the alternative adoption and elimination of vintaging in the past, the court's approval of the Commission's discretion in this regard, and the policy imperatives that would support elimination of the NGPA vintages as follows: [47]

> The Commission alternatively embraced and backed away from vintaging throughout the 1960's and 1970's. The elimination of vintaging has, therefore, been considered by the Commission and reviewed by the courts on several occasions.
>
> * * * *
>
> On judicial review of Opinion No. 699-H, the Court recognized that the Commission was not bound by its

[46] Appendix A.—Staff Analysis, Impact of the NGPA on Current and Projected Natural Gas Markets (Notice of Inquiry), IV FERC Stats. & Regs. ¶ 35,512 at 35,573 (1982).

[47] *Id.* at 35,573-74.

previous vintaging policies, but that the Commission should "be permitted latitude to evaluate old experiments and modify or abandon them when [its] best judgment require[s] such course of action." [*Shell Oil Co. v. FPC*, 520 F.2d 1061, 1077-78 (5th Cir. 1975), *cert. denied*, 425 U.S. 941 (1976).]

* * * *

[T]he principal difference between eliminating vintaging and not eliminating vintaging would not be the average price paid by consumers, but the distribution of wealth among producers and the ability of interstate and intrastate pipelines to compete with and among one another for new supplies. [footnote omitted.]

* * * *

Finally, vintaging may discriminate unreasonably against customers of pipelines that have a much smaller price cushion. If pipelines with low weighted average costs are in a better position to obtain new supplies, their customers are more certain of delivery of their supplies and lower prices. This advantage is the result of a pipeline's historical, fortuitous opportunities to contract for large volumes of low-priced vintaged gas and bears no rational relationship to its customers' demands or priority uses.

If anything, this analysis supports the final rule as issued and the rationales therein. Far from being an abrupt departure in policy, Order No. 451 should be understood as the culmination of a long study of the market-ordering problem, begun in the 1982 Notice of Inquiry.

Finally, the Commission disagrees with the assertions of Northern Natural and others that the disparity among pipelines' old gas cushions in most cases reflects more prudent and effective management by those pipelines en-

dowed with the larger cushions.[48] While some pipeline managements may have been more effective in negotiating for lower price supplies than others, a far more important factor was the fortuitous geographic location of certain pipelines near plentiful low-cost supplies subject to lower vintage prices. Moreover, the Commission anticipates that after Order No. 451 is fully implemented, and "the dust has settled" somewhat, those pipelines will continue to benefit from proximity to such fields and this advantage will be reflected in relatively lower WACOG's for such pipeline systems vis-a-vis competing pipelines. While the final rule will not result in absolutely level WACOG's, it should reduce the current spread in gas prices that comprise these WACOGs, by providing a framework for moderate increases in some old gas prices and commensurate reductions in some new gas prices. The final rule, by contributing to a more economically efficient market will benefit those managements that are most genuinely competitive and skillful by increasing their access to gas that may now be shut-in, and will enable them to bring that gas to market.

C. *Ceiling Price*

In Order No. 451 the Commission adopted DOE's proposal to establish the old gas ceiling price at a level equal to the existing ceiling price for post-1974 gas. That price was $2.57 per MMBtu as of June 1986, and is currently $2.61 per MMBtu. In selecting the post-1974 vintage rate as the ceiling price for old gas, the Commission relied on the theory of replacement cost pricing. The Commission found that prices based on replace-

[48] Midwest Energy Inc. (Midwest) is wrong in assuming that the Commission intended to suggest that KN and other pipelines with low WACOGs "secured their present low cost status by sharp or improper practices." Midwest at 4. Rather, the Commission views artificially low WACOGs on some systems as primarily adventitious, with management decisions having some effect on what is essentially a fortuitous phenomenon.

ment cost were necessary to assure an adequate long-term supply of natural gas, to eliminate distortion and excessive disparity in prices as between new and old gas prices, and to make the price structure of natural gas more economically efficient. (51 Fed. Reg. at 22,186-87). The Commission relied on the fact that the FPC had approved eventual pricing of all natural gas, including old flowing gas, at replacement costs levels, and the resulting elimination of vintaging, in the first national producer rate proceedings, Opinion No. 699-H,[49] was affirmed by the courts.[50]

In determining whether DOE's proposed ceiling price was representative of current replacement costs, the Commission reviewed the discounted cash flow (DCF) methodology used by the FPC in Opinion No. 770 to establish the post-1974 vintage rate. The Commission also considered an updated Opinion No. 770 DCF cost study submitted by Indicated Producers. The Commission concluded that the long-term replacement cost of gas was within a range between the post-1974 vintage rate of \$2.57 per MMBtu (as of June 1986) and the Indicated Producers' updated replacement cost estimate of \$2.77 per MMBtu. The Commission selected the post-1974 vintage ceiling price as the ceiling price for old gas. The Commission stated that while the \$2.57 per MMBtu rate might not reflect post-1976 DCF inputs as accurately as the Producers' study, the lower estimate was more reasonable under the circumstances because it recognizes that any prediction of replacement cost is subject to constant change in input variables and that adopting the lower estimate would protect consumers.

The Commission emphasized that the post-1974 rate adopted would operate only as a ceiling price, and that

[49] 52 FPC 1604 (1974). See also Opinion No. 639, 48 FPC 1299 (1972).

[50] Shell Oil Co. v. FPC, 520 F.2d 1061 (5th Cir. 1985), *cert. denied* 426 U.S. 941 (1976).

prices actually paid for old gas in the market pursuant to the good faith negotiation rule are likely to be substantially below the ceiling price as long as the current deliverability surplus continues. At such time as the market clears and supply and demand come into balance, the market price for old gas will increase. When this happens, the ceiling price will prevent market forces from driving the price of old gas above the level of replacement costs and will thus assure that old gas prices remain just and reasonable.

Requests for rehearing. Numerous parties seek rehearing of the Commission's decision in Order No. 451 to adopt a ceiling price for flowing gas based on replacement costs.[51] These parties argue that old gas prices must be based, either wholly or at least in part, on historical or original costs. Many rehearing applicants cite *City of Detroit v. FPC*, 230 F.2d 819 (D.C. Cir. 1956), and *Farmers Union Central Exchange, Inc. v. FERC*, 734 F.2d 1486 (D.C. Cir. 1984), in support of the claimed need to rely on historical costs. They further argue that the Commission in Order No. 451 erroneously relied on certain FPC and judicial decisions, notably FPC Opinion Nos. 699-H and 749 and their respective affirming court decisions, *Shell Oil Co. v. FPC*, 520 F.2d 1061 (5th Cir. 1975), and *Tenneco Oil Co. v. FERC*, 571 F.2d 834 (5th Cir. 1978), as supporting reliance on replacement costs in establishing old gas ceiling prices.

Rehearing applicants also argue that even if replacement cost pricing of old gas could be justified in theory,

[51] American Gas Association (AGA) at 5-7; INGAA at 4-7; UDC at 15-31; AGD at 2-3; Northern Distributor Group (NDG) at 3-5; Cal. PUC at 17-20; N.Y. PSC at 2-10; Texas Eastern Transmission Corporation (Texas Eastern) at 25-31; Florida Cities at 6-18; Southern Natural Gas Company (Southern Natural) at 6-11; Southern California Gas Company (SoCal) at 12-15; KP&L *et al.* at 6-9; Laclede at 6-13; Peoples Gas Light and Coke and North Shore Gas Company (Peoples Gas *et al.*) at 4-10.

the record in this case does not support such a policy. They argue that the FPC's decision in Opinion No. 699-H to grant higher prices for old gas and phase out vintaging were based on a finding made by the Commission and accepted by the reviewing court that in light of the natural gas shortage which then existed, a massive infusion of funds was required to help finance the search for new supplies. These parties argue that since gas deliverability now exceeds demand, there is no reason to believe that producers need additional revenues from sales of old gas to finance increased levels of exploration. It is alleged that under these circumstances, raising the ceiling price for old gas results in windfall profits for producers of old gas.[82]

A number of rehearing applicants also argue that the ceiling price adopted by the Commission has not been shown to accurately represent current replacement costs and that the Commission's finding in Order No. 451 that the post-1974 rate is representative of current replacement costs is not supported by substantial evidence.[83] They argue, for example, that the Commission failed to consider evidence that gas production costs, inflation rates and fuel prices have changed significantly since the Opinion No. 770 replacement cost formula was adopted and that, in particular, the cost of drilling for gas had declined in real terms since Opinion No. 770 was issued in 1976.[84] They argue that rather than relying on the Opinion No. 770 cost analysis adjusted for inflation or the updated study submitted by Indicated Producers, the Commission should have prepared an independent calcu-

[82] UDC at 31; Cal. PUC at 14; Florida Cities at 11; Southern Natural at 11; SoCal at 14; Peoples Gas *et al.* at 19; KP&L *et al.* at 16.

[83] AGA at 8-10; AGD at 3-4; Minnesota DPS at 4-5; SoCal at 15-16; Peoples Gas *et al.* at 21-22.

[84] AGA at 8; INGAA at 8; KP&L *et al.* at 24; SoCal at 16.

lation of current replacement costs.[85] Several parties also allege procedural errors in the Commission's consideration and determination of the ceiling price issue.

Commission response. In the Commission's judgment, the arguments presented on the replacement cost issue are without merit and do not justify modifying the old gas ceiling price adopted in Order No. 451. The Commission has previously considered and rejected assertions by the rehearing applicants that the Commission's authority to approve rates as just and reasonable under the NGA has been circumscribed as the result of enactment of the NGPA and that as a consequence the Commission may not adopt rate methodologies different from those used to determine the rates in effect at the time the NGPA was enacted. The Commission has likewise rejected contentions that adopting the post-1974 rate for flowing gas amounts to *de facto* deregulation of old gas. The Commission's reasoning on these issues is set forth in the discussion in section IV. A. *supra* and need not be repeated here. The principal issues raised by the rehearing applicants with respect to the level of the new ceiling price for old gas are (1) whether the Commission may properly base its determination of the just and reasonable rate for old gas on replacement costs, (2) whether the Commission's decision to do so is supported by the record, and (3) whether the post-1974 rate is representative of current replacement costs.

In Order No. 451, the Commission reviewed applicable Commission orders and court decisions pertinent to the establishment of just and reasonable producer rates under the NGA. (51 Fed. Reg. 22,185-86). The Commission noted that a vintaged rate structure was adopted with approval of the Supreme Court in the original *Permian Basin Area Rate Proceeding*, Opinion No. 468, 34 FPC

[85] Natural Gas Pipeline Company of America and United Gas Pipe Line Company (Natural and United) at 79; Peoples Gas *et al.* at 23; Southern Natural at 8; Minnesota DPS at 5.

159 (1965), that the Commission moved toward the establishment of uniform producer rates based on replacement costs in the first nationwide rate proceeding, Opinion No. 699-H, also with judicial approval, *Shell Oil*, *supra*, and that the Commission subsequently reinstated vintaging with court approval in the second national rate proceeding, Opinion No. 770, 56 FPC 509 (1976). The Commission concluded that the issues of replacement costs versus historical costs as well as vintage-based rates versus uniform rates are matters within the Commission's reasonably exercised discretion. 51 Fed. Reg. 22,186. The Commission has carefully considered the arguments presented by the rehearing applicants and concludes that they do not provide any basis for modifying the conclusions reached by the Commission in Order No. 451 concerning the Commission's authority to eliminate vintaging through the establishment of a uniform ceiling price for old gas based on replacement costs.

The reliance by numerous parties on the *City of Detroit* case in support of the proposition that gas producer rates must be based either in whole or in part on historical or original costs is misplaced. *City of Detroit* involved a pipeline rate proceeding in which the FPC authorized the pipeline to charge the so-called "field price" or "commodity value" for its own gas production. In setting aside this part of the FPC's order, the Court stated as follows (230 F.2d at 818-19) (emphasis added):

> "when we refer to an 'increase' we mean an increase in the rates above those which would result from use of the *conventional rate base method*. For, though we hold that method not to be the only one available under the statute, it is essential in such a case as this that it be used as a basis of comparison. It has been repeatedly used by the Commission and repeatedly approved by the courts, as a means of arriving at lawful just and reasonable rates under the Act. Unless it is continued to be used at least as a point of departure, the whole experience under the Act is discarded and no anchor, as it were, is available by which to hold the terms 'just and reasonable' to some recognized meaning."

It has long ben recognized that the rate standards set forth in the *City of Detroit* are not directly or specifically applicable to the establishment of gas producer rates. In reviewing the FPC's Opinion No. 586 establishing the producer rates for the Hugoton-Anadarko area, the United States Court of Appeals for the Ninth Circuit stated, with reference to *City of Detroit*, that "that case involved a single pipeline company cost-of-service problem. The application of that decision to a review, as in the case before us, of a producer-area rate opinion and order is questionable to say the least." [56] The Commission likewise rejects the assertions of the rehearing applicants that the old gas ceiling price adopted in Order No. 451 violates standards for just and reasonable rates set forth in *Farmers Union*. In Opinion No. 154 (the *Williams* proceeding), which was the subject of the *Farmers Union* decision, the Commission proposed to adopt certain unconventional ratemaking methods for the purpose of determining rates for oil pipelines. These methods were adopted for a number of reasons including the Commission's interpretation of the legislative history of the Lodge Amendment to the Hepburn Act adopted by Congress in 1906.[57] The Commission acknowledged that

[56] In re Hugoton-Anadarko Area Rate Case, 466 F.2d 974, 989 (9th Cir. 1972). The court went on to cite the Supreme Court's decision in Wisconsin v. FPC, 373 U.S. 294 (1963), concerning the view expressed in *City of Detroit* that cost of service must be used "at least as a point of departure." The Supreme Court there stated that "whatever the court may have meant in that context, it is clear that it did not have before it any question relating to the area rate method." 373 U.S. at 310, n.16.

[57] *See Williams Pipe Line Company*, 21 FERC ¶ 61,260 at 61,582, n.78 and n.124 (1982).

the methods adopted in Opinion No. 154 result in rates substantially in excess not only of those derived through application of traditional cost-of-service methodologies but also of those estimated by the Commission to be normally obtainable through the operation of market forces. The court in *Farmers Union* rejected the cost methodologies proposed by the Commission, finding that the Commission's rejection of original cost rate-making lacked both evidentiary support and "economic common sense," 734 F.2d at 1515. The court held that oil pipeline rates must be set within the zone of reasonableness and that "presumed market forces may not comprise the principal regulatory constraint," *id.* at 1530.

We believe that due to the substantial differences in regulatory context, *Farmers Union* is no more applicable to gas producer regulation than *City of Detroit.* More importantly, there is no parallel between the methods adopted in *Williams* and those adopted in Order No. 451. The rate adopted in Order No. 451 is in no way designed merely to restrain "gross overreaching" or solely as a protection against "egregious exploitation and gross abuse," *id.* at 1502. Order No. 451 establishes a cost-based rate within the zone of reasonableness established by reference to prior FPC and court approved ratemaking principles and is supported by sound economic and regulatory policy.

The Commission also rejects the arguments of the rehearing applicants that Order No. 451 violates *City of Detroit* and *Farmers Union* not only for failure to adopt an original-cost ratemaking methodology but also for its alleged reliance on market forces to establish the rates actually charged. The establishment of a ceiling price based on replacement costs which, under existing market conditions, is in excess of prevailing market prices does not constitute an abdication of the Commission's regulatory responsibility in favor of market pricing. Any such argument ignores the very real limitation represented by

the ceiling price. The rate actually charged, while possibly below replacement cost, cannot exceed that level. Contracting parties have always been and continue to be free to negotiate prices up to but not in excess of applicable ceiling prices. Under the *Mobile-Sierra* doctrine, negotiated, below-ceiling prices are the lawful just and reasonable rates. There is no reason to assume that sales should uniformly be made at the ceiling price. The fact that particular sales can and undoubtedly will be made at prices lower than the ceiling price in no way supports the suggestion that the ceiling price is without regulatory force or effect.

In Order No. 451, the Commission relied on the FPC's first national rate proceeding, Opinion No. 699-H, as support for the pricing of old gas based on replacement cost. The Commission also relied on FPC Opinion No. 749 as supporting the Commission's discretion to consider replacement costs in setting just and reasonable rates for old flowing gas. Several applicants argue that these interpretations are erroneous, that the FPC never totally eliminated vintaging or established a single price for all NGA regulated gas, and that there is thus no valid precedent for the Commission's adoption of the post-1974 rate for all flowing gas.[58]

It will be helpful in considering the arguments of the rehearing applicants briefly to review the FPC's decisions in the national producer rate proceedings conducted prior to enactment of the NGPA. In Opinion No. 699-H, the FPC established a just and reasonable rate of 50 cents per Mcf for 1973-74 biennium gas, with annual escalations of one cent per Mcf. The Commission also ruled that the 1973-74 biennium gas would be entitled to be priced at the rate established for each succeeding period. 52 FPC at 1636. The FPC in Opinion No. 699-H also extended its policy originally adopted in Opin-

[58] INGAA at 6-7; UDC at 23-27; Florida Cities at 13-16; Laclede at 9-12.

ion No. 689 of eliminating vintaging through the vehicle of allowing replacement contracts (contracts which replace expired or expiring contracts) to receive the new gas price. 52 FPC at 1631-32. The agreement of the purhcaser to pay the higher rate was required, *id.* The FPC acknowledged that its decisions in Opinion No. 699-B would lead over an extended period of time to a uniform rate for all gas sold in interstate commerce. In support of its policy, the FPC stated as follows (52 FPC at 1637):

> This uniform price will constitute a recognition of the fact that gas is a consumable, irreplaceable commodity and not a service which can be renewed by man. Thus, there is no rational basis for setting differing price levels based upon date of discovery, lease acquisition, contract, or well commencement or completion over an extended period of time.

In Opinion No. 749, the FPC established the national rate for gas flowing in interstate commerce prior to January 1, 1973. The FPC adopted a uniform old gas rate of 29.5 cents per Mcf based on a 1972 test year, thereby eliminating the vintage categories of old gas adopted in various prior area rate proceedings.[59] In the second national rate proceeding for new gas, the FPC adopted a full DCF cost methodology resulting in a 1975-76 biennium rate of $1.42 per Mcf. In light of the magnitude of this increase over the pre-existing new gas rate of 50 cents per Mcf, the FPC reimposed vintaging. It did provide, however, that upon contract expiration, old gas would still be entitled to the 1973-74 biennium rate of 50 cents adopted in Opinion No. 699-H.

Rehearing applicants argue that Commission reliance on Opinion No. 699-H is misplaced because (1) it did not

[59] Producers were permitted to continue to collect certain special rates and area rates which were higher than the Opinion No. 479 ceiling price. 54 FPC at 3098.

eliminate vintaging immediately but rather over time as old gas contracts expired; (2) it was based on a shortage situation and the need for infusion of capital to producers; and (3) the devintaging policy was reversed in Opinion No. 770. The Commission recognizes the differences between Opinion No. 699-H and Order No. 451 in the manner in which devintaging would be accomplished; the Commission also recognizes that the FPC's devintaging plan was discontinued in Opinion No. 770. These facts, however, do not invalidate Opinion No. 699-H as a precedent for the elimination of vintaging through establishment of a replacement-cost-based ceiling price.

First, Order No. 451, like Order No. 699-H, does not authorize producers to immediately or automatically collect the post-1974 rate. Whereas Opinion No. 699-H required producers to execute replacement contracts and thus obtain their purchasers' approval in order to obtain the new gas ceiling price, Order No. 451 requires producers to negotiate their old gas contracts with their purchasers pursuant to the good faith negotiation rule and does not require any purchaser to pay the new ceiling price without its consent. Producers may abandon sales of old gas if no price agreement is reached, but purchasers may also release higher-priced gas subject to renegotiation if no price agreement is reached. Thus, while there are differences between Opinion No. 699-H and Order No. 451, there are also fundamental similarities. In the Commission's judgment, the ratemaking policy incorporated in Order No. 451 is significantly similar, even analogous to that in Opinion No. 699-H, and the Commission therefore believes that Opinion No. 699-H may properly and reasonably be relied upon as precedent supporting the findings and conclusions adopted in Order No. 451.

The Commission also believes that the efficacy of Opinion No. 699-H as a precedent is not diminished by the later issuance by the FPC of Opinion No. 770. A review

of the pertinent cases decided by the FPC prior to enactment of the NGPA reveals clearly that the FPC was given reasonable discretion to determine whether to require or discontinue vintaging and whether to rely on historical or replacement costs, so long as its decisions were within the zone of reasonableness and supported by the record. The fact that the Commission initially instituted vintaging, later moved to abandon it, and subsequently reinstated it, all with judicial approval, supports this view.

The Commission also rejects arguments that Order No. 451 misinterprets or misapplies the decision in *Tenneco, supra.* In Order No. 451, the Commission relied on *Tenneco* for the proposition that the Commission has discretion to select between historical or replacement cost in establishing just and reasonable rates for old gas. The Commission relied on the court's statement that "Insofar as theories of regulation are concerned, the choice between actual and replacement cost is for the Commission to make, subject to the sole requirement that the end result be within the 'zone of reasonableness'" 571 F.2d at 840. Parties objecting to the Commission's reliance on *Tenneco* point out that the court also noted in its opinion that under the Constitution as well as the NGA, producers are only entitled to a fair return on their "actual costs"[60] and that the FPC's Opinion No.

[60] The pertinent portion of the Court's decision reads as follows (571 F.2d at 840):

> The "zone of reasonableness" is wide. The producers, under the Constitution as well as the [NGA], are at bottom, only entitled to a fair return on their actual costs, i.e., a rate which, if anticipated at the time their wells were dug would be sufficient to "maintain financial integrity, attract necessary capital, and fairly compensate investors for the risks they assumed." *Permian*, 390 U.S. at 792, 88 S.Ct. at 1373. Subsequent increases in operating costs would be taken into consideration, but replacement value would not.

749, which was the subject of the *Tenneco* decision, did not actually adopt replacement cost pricing for old gas.

The Commission believes that *Tenneco*, in affirming the FPC's old gas pricing policy adopted in Order No. 749, is relevant to the issue of replacement cost pricing. Although the FPC did not in Opinion No. 749 adopt a flowing gas ceiling price based solely on replacement costs, it did eliminate vintaging of old gas through the adoption of a uniform ceiling price based on then-current (1972) exploration and development costs rather than purely historical costs. 54 FPC at 3105. As the court in *Tenneco* observed (571 F.2d at 837-38):

> In calculating costs, the Commission made a number of judgments challenged here. It chose to measure exploration and development costs by using a 1972 test year, even though many of the wells from which the gas comes were developed at a lower cost years earlier.

The Commission does not concede that its findings in Order No. 451 are in any way based on a misinterpretation or distortion of the holding in *Tenneco*. Although Opinion No. 749 and the related decision in *Tenneco* are not as directly relevant to the replacement cost issue as Opinion No. 699-H, we believe they support the Commission's discretion to eliminate vintaging of old gas and to choose between replacement and historical cost in setting just and reasonable rates for old gas. Clearly *Tenneco* does not support the claim by rehearing applicants that old gas ceiling prices must remain vintaged as well as based on historical costs. For the reasons discussed above, the Commission reaffirms its determination in Order No. 451 that it is permissable for the Commission to establish a uniform ceiling price for old gas based on replacement costs.

The next principal issue to be considered is whether the record in this proceeding supports the Commission's decision in Order No. 451 to base the ceiling price for

old gas on replacement costs. A number of parties argue that the FPC's decision in Opinion No. 699-H was justified on the basis of the then-existing natural gas shortage in the interstate market and the need for "vastly expanded exploration and development programs to meet future demand. . . ." 52 FPC at 1613.[61] It is argued that the NGPA, which eliminated the interstate-intrastate regulatory dichotomy and incorporated incentive prices for new gas and special rates to support continuing or incremental production from old wells, has resulted in a gas surplus and that there is therefore no emergency need to increase old gas prices as a means of financing exploration for increased supplies. New York Public Service Commission, for example, argues that the use of replacemnet cost as a basis for old gas ceiling prices would be lawful only if the Commission could find that the resulting additional producer revenues are necessary to provide investment funds needed for adequate exploration and development of new supplies and that such additional revenues will actually be used for that purpose. According to New York, "the Commission has not made any such finding and none would be possible on the basis of the record before it." [62]

The Commission agrees that the FPC's decision in Opinion No. 699-H was based on the gas shortage which then existed and the need to finance a greatly increased program of exploration and development of additional supplies; the Commission likewise agrees that the present market is characterized by oversupply in relation to demand. It follows that the rationale relied upon by

[61] The FPC in Opinion No. 699-H stated that "the magnitude of the drilling effort that will be required to elicit the supply of gas necessary to fulfill reasonable future demands calls for massive capital commitments." 52 FPC at 1638 (footnote omitted). This finding was accepted by the reviewing court in Shell Oil Co. v. FPC, 520 F.2d at 1077 (5th Cir. 1975).

[62] N.Y. PSC at 8.

the Commission in Opinion No. 699-H is not applicable in light of present industry conditions. However, the Commission disagrees with the suggestion that replacement cost pricing of old gas can be justified solely and exclusively on the grounds specified in Opinion No. 699-H. We believe that replacement cost pricing is supported by the record in this proceeding, albeit for reasons different from those set forth in Opinion No. 699-H.

In Order No. 451, the Commission reviewed the record and concluded that the pre-existing old gas price structure was unjust and unreasonable (51 Fed. Reg. 22,179-83). The Commission determined that the old gas price structure was the principal cause of distortion in the natural gas market, prevented fair competition, failed to accurately reflect the cost and market value of the many categories of old gas, and resulted in inefficient production and the potential loss of trillions of cubic feet of old gas reserves. The Commission also noted that the elimination of vintaging had been contemplated since the inception of formal producer price regulation commencing with the FPC's original Statement of General Policy No. 61-1 in 1960 (51 Fed. Reg. 22,182). The Commission further noted (51 Fed. Reg. 22,182-83) that the courts reviewing its orders had observed that the vintage-based pricing system was anomalous, *Placid Oil Co. v. FPC*, 483 F.2d 880 (5th Cir. 1973), and resulted in a "gargantuan inequity." *Tenneco, supra.* (51 Fed. Reg. at 22,185). The Commission further found that under the partially decontrolled pricing system adopted by the NGPA, it was inevitable that where old gas prices were frozen at levels equal to only a fraction of replacement cost, prices of unregulated supplies would become disproportionately high to enable producers to realize overall prices over the long term at least equal to replacement cost (51 Fed. Reg. 22,186). The Commission found that this is what occurred following enactment of the NGPA, that the resulting price distortions between new and old gas are a prime cause of dysfunction in today's nat-

ural gas market, and that further exacerbation of the distortion in natural gas prices is likely to occur at such time as the current surplus is eliminated and supply and demand come into balance. (51 Fed. Reg. 22,187).

The Commission has reviewed the arguments of the rehearing applicants and finds they provide no basis for modifying the conclusions reached in Order No. 451. The Commission has reviewed and reaffirms its findings in Order No. 451 that the existing old gas price structure is unjust and unreasonable and should be replaced by a uniform old gas ceiling price based on replacement cost. The Commission believes the issues related to both the old and new price structure for old gas were fully considered in Order No. 451 and that the determinations made were fully justified for the reasons stated.

The Commission is convinced that it is essential in selecting a proper cost basis for old gas ceiling prices to recognize the fundamental differences between the exploration for, and production and sale of natural gas and the providing of traditional utility services. As the Commission has previously observed, natural gas is a "consumable, irreplaceable commodity and not a service which can be renewed by man." Opinion No. 699-H, 52 FPC at 1637. An electric generating plant can be constructed which may last for decades and produce electricity virtually on demand and in the amounts desired. Similarly, a pipeline can be constructed for use over an extended period through which gas can be transported on demand and in the quantities desired. The same is true for other utility services such as transportation or telephone services. By contrast, natural gas is a non-renewable energy resource. The total supply of gas, while not precisely known, is finite, and the ultimate stock provided by nature cannot be replenished. The compelling need to replace natural gas consumed is the driving force behind the entire natural gas industry. It is reasonable

that consumers of gas should pay prices up to but not in excess of the cost of replacing the volumes which they consume. Gas prices that are equal to only a fraction of replacement cost encourage the rapid, inefficient consumption of this non-renewable resource.

The Commission firmly believes that it is inconsistent with logic, common sense and economic reality to have multiple, binding ceiling prices for a fungible commodity, whether it be bushels of wheat, bars of gold, bales of cotton, barrels of oil or Btus of natural gas. *Placid Oil, supra.* Of course, uniform pricing of natural gas is not possible absent total deregulation. However, the adoption of a uniform ceiling price reflecting replacement costs constitutes a significant step in the right direction and the most the Commission can do within the limits of its statutory authority. In Opinion No. 770, the FPC held that reimposition of vintaging was necessary to "preclude the exaction of excessive and unjustifiable economic rent from flowing gas." 56 FPC at 521 (1976). The Commission rejects this finding in Opinion No. 770 to the extent it implies that in workably competitive wellhead markets any economic rent realized by producers for the sale of flowing gas could be judged to be "excessive and unjustifiable." The Commission is finding in this rulemaking that pricing old gas at its replacement cost over the long-term will assure that economic rents exacted by all producers for all gas will be most responsive to competitive conditions in wellhead markets as mandated by the NGPA. If competitive conditions in energy markets permit producers a higher return in exploration and development than in other endeavors, then such investments will be made. If energy markets do not permit the producer a higher return on exploration and development than on other investments, then the economic rents may not be reinvested in additional drilling. In both cases, the economic rents are allocated in a market-responsive manner consistent with the competitive conditions mandated by the NGPA. For this rea-

son, the Commission finds that this rule will not result in the "exaction of excessive and unjustifiable economic rent from flowing gas." Furthermore, in Order No. 451 the Commission determined that some old gas prices would increase while other old gas prices would decrease under the good faith negotiation provisions. The Commission also found that the increased ceiling price for pre-1974 gas would allow some old gas wells to operate to a lower pressure and level of production, thereby permitting the wells to produce a greater percentage of resources-in-place. Without this price incentive the Commission estimated that a significant amount of old gas would not be produced. For these reasons, the Commission concludes that the record as well as economic common sense and sound regulatory policy dictate that the ceiling price of old gas be based on replacement rather than historical costs.

In considering the means by which to implement replacement cost pricing, the Commission reaffirms its support for the analysis submitted by DOJ. DOJ argues persuasively that in a competitive industry, market forces drive prices toward the producer's marginal cost. 51 Fed. Reg. at 22,186. In the terminology of producer regulation, this means replacement cost. Thus in a competitive industry, market prices will reflect replacement cost and regulation is theoretically unnecessary.

There can be no reasonable doubt that the natural gas producing industry is workably competitive. The Commission so found in Order No. 451, citing Congress' implicit finding of competitiveness in enacting the NGPA, judicial acknowledgments of such Congressional intent, and the declining trend in gas prices since 1984 resulting from conditions of oversupply. (51 Fed. Reg. at 22,195-96). Other available evidence supports the finding of a competitive natural gas market among sellers. EIA, for example, prepared a comprehensive study of the concentration of interstate sellers in some nine regional pro-

ducing areas and 26 production sub-areas.[40] The results of this study indicate a low level of seller concentration in every market except Alaska and similarly low levels of seller concentration in 23 of 26 producing areas.[41] These findings are consistent with and support conclusions reached in earlier studies.[42]

Despite the Commission's finding of competition among sellers of natural gas and the resulting absence of any real need for wellhead price controls, the Commission nevertheless, out of necessity as well as an abundance of caution, adopts the post-1974 ceiling price recommended by DOE. The basis for Commission approval of this ceiling price is replacement cost. The Commission recognizes that there is no perfect formula for calculating replacement cost. Because of the characteristics of the natural gas producing industry, including high risk, price variability, joint products, and fluctuating costs, there can be no one price which is precisely representative of replacement cost. The Commission believes, however, that the DCF model adopted by the FPC in Opinion No. 770 is the most reasonable method available for purposes of estimating current replacement costs.

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[40] Richard P. O'Neill, James B. Tobin, and Henry Clarius, "Pipeline Mergers and Their Potential Impact on Natural Gas Markets", *Natural Gas Monthly*, Energy Information Administration, February 1986.

[41] *Ibid.* at Tables F3 and F4. Data for the remaining 3 areas was inadequate or incomplete. Most sales in these areas were in intrastate commerce or in certain instances only a few sales occurred. These areas together accounted for less than 1 percent of total interstate sales in 1984.

[42] Joseph P. Mulholland, *The Economic Structure and Behavior in the Natural Gas Production Industry*, Federal Trade Commission, February 1979. Ronald R. Braeutigam, "The Deregulation of Natural Gas", in *Case Studies in Regulation: Revolution and Reform*, ed. by Leonard W. Weiss and Michael W. Klass, Little, Brown and Co., (Boston: 1981).

As outlined in detail in Order No. 451 (51 Fed. Reg. 22,185-88), the post-1974 rate had its origin in Opinion No. 770, in which the FPC adopted a rate for post-1974 gas of $1.42 per Mcf. The rate was increased by one cent per quarter until enactment of the NGPA and thereafter adjusted according to the NGPA's monthly inflation adjustment. The Commission concluded that the DCF cost methodology adopted in Order No. 770 remained a reasonable method of calculating the replacement cost of gas. The Commission also held that in light of the adjustment-for-inflation feature of the NGPA, it was reasonable to assume the current post-1974 ceiling price remained representative of replacement costs absent a showing that the inflation adjustment had either overstated or understated changes in the cost of finding and producing gas since enactment of the NGPA. The Commission also considered and found reasonable the replacement cost study submitted by Indicated Producers demonstrating a 1985 replacement cost of $2.77 per MMBtu. The Producers' study represents an updated application of the Opinion No. 770 methodology incorporating recent data concerning productivity, reserve additions, income tax liability, drilling costs, and industry capital structure.[illegible]

Certain rehearing applicants argue that the Commission has failed adequately to demonstrate that the post-1974 rate is representative of current replacement costs. Several applicants argue that the Commission's assumption, based on the NGPA monthly adjustment factor, that the post-1974 rate remains representative is without adequate support, and that such an assumption is belied by the fact that drilling costs have actually declined. Several

[illegible] The Commission also notes a recent study of oil and gas replacement costs presented to the Cost Study Committee of the Independent Petroleum Association of America, finding a current replacement cost of $4.00 per Mcf for gas. *See* "Analyst Suggests True Oil Replacement Costs Cause Heavy Financial Pressure," *The Oil Daily* (November 20, 1986), p. 2.

applicants also question the Commission's reliance on the Indicated Producers' replacement cost study.

The Commission agrees that the NGPA's inflation adjustment factor, in and of itself, does not assure that the original Opinion No. 770 rate will remain representative of replacement cost. The Commission agrees therefore that it would be improper to rely solely on the inflation factor to justify the reasonableness of the current post-1974 rate. However, the Commission has not relied solely on the NGPA's adjustment factor, the Commission also carefully reviewed the updated Opinion No. 770 study submitted by Indicated Producers and found it to be reasonable and to confirm the reasonableness of the post-1974 rate proposed by DOE. Rehearing applicants' objections to the Commission's reliance on the Producers' study are without merit. The Producers' study was submitted as part of the initial comments of Indicated Producers. All parties had an opportunity to respond to all of the issues raised in the initial comments including the Producers' replacement cost study. No party has presented any facts, evidence, or information whatsoever, either in their reply comments or on rehearing, challenging the validity of the Producers' study as representing a valid estimate of current replacement costs based on the Opinion No. 770 DCF model.

The Commission has again reviewed the study and finds that it represents an accurate and reasonable application of the Opinion No. 770 methodology. The Commission therefore properly adopts this study as representing a reasonable measure of the current replacement cost of natural gas, and finds its underlying assumptions to be reasonable. The Commission specifically approves as reasonable the Producers' productivity factor of 145 Mcf per successful gas well foot drilled. The Commission likewise adopts as reasonable the Producers' drilling costs of $70.10 per foot for successful wells and $59.67 per foot for dry holes. In estimating 1985 drilling costs, Produc-

ers' trended actual 1984 costs downward based on data reported by EIA and API.[67] Successful well costs were adjusted downward 21 percent from $88.73 per foot (actual) in 1984 to $70.10 (estimated) in 1985; dry hole costs were adjusted downward 10 percent from $66.52 (actual) in 1984) to $59.67 (estimated) in 1985.[68] However, if the index-based adjustment procedure actually utilized by the FPC in Opinion No. 770 (56 FPC at 543) were applied to actual 1984 drilling costs the result would be estimated 1985 drilling costs of $83.94 per foot for successful wells and $62.93 per foot for dry holes.[69] Producers' 1985 drilling cost estimates may thus fairly be characterized as conservative.

Several applicants allege procedural flaws in the Commission's consideration of replacement costs.[70] They argue that there was insufficient notice of the Commission's intent to rely on the Opinion No. 770 DCF cost analysis in establishing the ceiling price for old gas and that the Commission should reopen the record and prepare its own cost study which would then be subject to further comment by all interested persons.[71]

The issue of replacement cost pricing has been raised throughout these proceedings. DOE's proposal was based in part on the fact that the old gas price structure failed to assign a reasonable share of replacement costs to pur-

[67] Indicated Producers' initial comments, Appendix A, Exhibit B, Schedule 3. Actual 1985 drilling costs have not yet been reported by the Joint Association Survey.

[68] *Ibid.*

[69] The current value for the adjustment index used in Opinion No. 770 is obtained from IPAA Report of the Cost Study Committee, Midyear Meeting, Nashville, Tennessee, May 1, 1986, Table 1. That index is 94.6, representing a decline of 5.4 percent from 1984. Applying this adjustment factor to actual 1984 drilling costs results in $83.94 per foot for successful wells and $62.93 per foot for dry holes.

[71] NDG at 13; APGA at 78-80.

chasers of old gas. 50 Fed. Reg. at 48,541 (November 29, 1985). DOE and Indicated Producers, among others, specifically relied in their initial comments on the concept of replacement cost to support DOE's old gas pricing proposal,[72] and the issue was fully discussed in the parties' reply comments. In fact, the Commission requested reply comments for the very purpose of providing an opportunity to respond to each issue. It is noteworthy that the ceiling price proposed by DOE and adopted in Order No. 451 is a replacement cost price; the source of the post-1974 rate in Opinion No. 770 is a matter of common knowledge. The argument that interested persons did not have full opportunity in this proceeding to submit their views on the issue of replacement cost pricing is thus simply not credible.

The Commission also rejects the suggestion that the record in this proceeding is incomplete or inadequate without a separate 1985 replacement cost study prepared by the Commission or its staff. It is true that the Commission staff developed proposed cost models in the prior national rate proceedings. However, those proceedings involved issues concerning cost methodology as well as cost level and various parties submitted cost studies incorporating a variety of suggested methodologies.[73] Here, however, no question of methodology is involved. The Commission has found the Opinion No. 770 DCF method to be reasonable, and the only thing necessary to do is apply the Opinion No. 770 methodology. Indicated Producers did this in the DCF study included in their initial comments. The Commission has critically reviewed the study and reaffirms its prior conclusion that the Indicated Producers' study is reasonable and properly reflects application of the Opinion No. 770 principles. The Commission notes that the Tax Reform Act of 1986 was

[72] DOE at 19-22, 36-37; Indicated Producers at 31-34, 41-46, Appendices A and C.

[73] *See, e.g.*, Opinion No. 770, 56 FPC at 519.

enacted subsequent to the issuance of Order No. 451. The Tax Reform Act modified certain of the assumptions used in the Producers' DCF study, notably the federal corporate income tax rate and allowance for investment tax credits (ITC). The Tax Reform Act provides for a corporate tax rate of 34 percent (effective July 1, 1987) as compared to the 46 percent used by Producers and for elimination of ITC in contrast to the eight percent rate used by Producers. Substituting these changes in tax provisions in place of those utilized by Producers' results in a slight overall reduction in the 1985 replacement cost estimate from $2.77 to $2.71 per MMBtu.

As a further check on the reasonableness of the 1985 estimated replacement cost, the Commission has calculated replacement costs for each year 1979 through 1984 using the Opinion No. 770 DCF methodology and the Producers' application of that methodology. Actual drilling costs and actual productivity values for each year were utilized. The resulting replacement costs, which vary from $3.05 per MMBtu in 1979 to over $6.00 per MMBtu in 1982 are shown in the following table. The average replacement cost for the entire 1979-1984 period is $3.98 per MMBtu.

Year	Successful Well Cost $/foot [74]	Dry Holes $/foot [74]	Productivity Mcf/foot [75]	Replacement Cost With 4% Escalator
1979	80.54	63.21	148	$3.05
1980	94.87	72.08	130	4.07
1981	121.70	88.63	202	3.32
1982	145.96	102.62	130	6.13
1983	108.37	77.75	155	3.86
1984	88.73	66.52	143	3.44

[74] Based on actual costs and footage published in the Joint Association Survey 1979-1984.

[75] For 1979, Reserves of Crude Oil, Natural Gas Liquids, and Natural Gas in the U.S. and Canada and U.S. Productive Capacity, AGA-API-CPA. For 1980-1984, U.S. Crude Oil, Natural Gas, and Natural Gas Liquids Reserves, Annual Reports, DOE-EIA.

These results demonstrate the variability of replacement cost estimates from year to year. It may be seen, however, that the Producers' estimate of $2.77 ($2.71 adjusted for tax changes) is conservative when measured in relation to the total range of annual replacement cost values resulting from application of the Opinion No. 770 model. For the foregoing reasons, the Commission denies the requests for rehearing on the ceiling price issue and reaffirms its conclusion that the old gas ceiling price adopted in Order No. 451 is just and reasonable within the meaning of the NGA.

D. *Supply Response.*

In Order No. 451, the Commission found that eliminating vintaging will substantially increase recoverable old gas reserves through delayed abandonment of wells. The Commission reasoned that the increased ceiling prices for pre-1974 gas will allow wells to operate to a lower pressure and level of production before the net present value of future costs outstrip the net present value of future revenues, thereby permitting the wells to produce a greater percentage of reserves. The Commission reached this conclusion after a careful review of various studies in the record, including those by DOE, Indicated Producers and AGA, concerning the effect of eliminating vintaging on recoverable reserves.

Those studies generally followed a methodology first developed in an April 1983 study by the Shell Oil Company estimating the increased production from total decontrol of natural gas prices. Under that methodology, the increase in recoverable reserves in the fourteen largest gas fields in the United States is first estimated. This is done by estimating (1) the pressure at which each field would be abandoned under current prices, (2) the lower abandonment pressure of the fields under the new ceiling prices, and (3), based on these estimates and reserve data for the fields, the resulting increase in recoverable reserves. The fourteen field data is then

extrapolated to a nationwide basis to estimate the total increase in production. This is done in such a way as to account for the fact that some old gas may qualify for NGPA incentive or deregulated prices in any event and other old gas, including that subject to fixed rate clauses, may not receive an increased rate. (The fourteen field data does not take those factors into account.) The Indicated Producers' study predicted an increase in recoverable reserves from eliminating vintaging of 16 Tcf. DOE estimated an increase of 9 to 12 Tcf, with its best estimate 11 Tcf. AGA predicted an increase of approximately a third that predicted by DOE. The Commission found the DOE estimate to be the most reliable of the three. The Commission's analysis of the AGA study revealed a number of errors not made by DOE, which caused AGA to underestimate the probable supply response. Similarly, the Shell study contained errors causing an overestimate of the probable supply response.[76] The Commission, however, emphasized the uncertainty of any prediction of the exact amount of the increase, since many of the relevant variables, including future market prices, are uncertain.

Rehearing Requests. On rehearing, a number of applicants attack the Commission's finding of a substantial increase in recoverable reserves through delayed abandonment. Only AGA, however, makes a detailed critique of the Commission's reliance on the DOE study.[77] AGA contends that, in estimating the supply response from the fourteen fields, the DOE study improperly assumed prices would rise to the new ceiling price,[78] used outdated data from different time periods for reserves and abandonment pressures, and failed to account for the fact that under

[76] The errors in the AGA and Shell studies are fully discussed in Part IV. D of Order No. 451, 51 Fed. Reg. at 22,191-22,193.

[77] AGA at 10-17.

[78] *See also* Northern Natural at 29.

current law producers may in many cases collect compression costs in addition to the ceiling price. AGA also contends that the DOE study made errors in extrapolating the fourteen field data to a national level. Allegedly, the DOE study improperly included some intrastate gas in its predicted increase. It also failed to account for the fact that most of the predicted increase would occur in any event under the NGPA section 108 incentive prices for stripper wells.[79] Finally, it used 1981 national reserve figures in making the extrapolation, thus failing to account for the fact that reserves produced since 1981 are no longer available for increased production.

Other applicants for rehearing, while not addressing the specifics of the DOE and other studies, question the general conclusion that eliminating vintaging will substantially increase recoverable reserves. Several applicants state that the increased production cannot occur during a time, such as now, when there is a natural gas surplus. Others contend that, even assuming increased production of old gas and a concomitant lowering of overall prices as predicted by the Commission, the result will be a sharp decrease in new drilling and stripper well activity, causing a decrease in new production. This allegedly will offset the increased production of old gas, causing a gas shortage and higher prices. Furthermore, some applicants contend, the incremental cost of the increased production of the old gas (the increased cost of all old gas divided by the increase in recoverable reserves) will be exorbitant.

Commission Response. The Commission continues to believe that eliminating vintaging will cause a substantial increase in recoverable reserves of old gas. Furthermore, nothing raised on rehearing causes the Commission to modify its belief that DOE's study predicting an ap-

[79] APGA at 34 contends that the increased supply response could also occur pursuant to special relief.

proximate 11 Tcf increase is the most convincing analysis in the record of that increase.

In its rehearing request, AGA again contends that DOE made a number of errors in estimating the increase in recoverable reserves in the fourteen field study. Several of AGA's allegations of error are incorrect, and AGA has not shown that the other alleged errors affect the validity of DOE's prediction of a substantial increase in reserves in the fourteen fields. First, AGA contends that DOE incorrectly assumed that old gas prices would rise to the new alternative ceiling price (now $2.61) rather than to the current market price alleged to be approximately $1.90.[80] AGA alleges that if DOE had used $1.90 its prediction of increased production would have been cut by one-third. The Commission rejects this contention.

For purposes of predicting the increase in recoverable old gas reserves, estimated average prices over the next twenty to forty years should be used, since old gas is not expected to be exhausted before then. While future gas prices cannot be projected with certainty, it is unlikely that current depressed prices will continue indefinitely. The current low price of gas has resulted in a dramatic drop in drilling activity.[81] Therefore, it appears inevitable that the current surplus deliverability will disappear and that as a result prices will increase in order to maintain an equilibrium between supply and demand. For these reasons, the Commission believes that DOE's projection that gas prices will reach the new ceiling price by 1990 is reasonable. This price thus seems a reasonable basis for projecting the supply response from eliminating vintaging, since the majority of abandonment decisions will be made after 1990. In addition, even pre-1990 abandonment decisions will take into account expected higher future prices since producers abandon wells

[80] *See also* Northern Natural at 29 and Florida Cities at 21.

[81] Northern Natural at 29-30.

only when the net present value of total predicted future costs exceed the net present value of total predicted future revenues.[82]

Second, AGA contends that much of the increased production claimed from the fourteen fields as a result of Order No. 451 would occur in any event because of the availability of the compression allowance under NGPA section 110.[83] Section 271.1104(d)(iv) of the Commission's regulations allows a producer to collect such allowances[84] in addition to the maximum lawful price, if the producer's contract expressly authorizes collection of compression costs and if the compression facility was installed after enactment of the NGPA.[85] AGA argues, in effect, that when DOE determined the pressure at which each of the fourteen fields would be abandoned at current prices, it assumed that current prices equal the existing ceiling prices, failing to take into account producers' ability to collect more than the current ceiling price through a compression allowance. In view of the au-

[82] If, despite the facts stated above, prices fail to rise to the new ceiling price (perhaps because of competition from alternative fuels) then it is likely that recoverable reserves will not increase as much as projected by DOE. However, any market force sufficiently strong to keep old gas prices significantly below the new ceiling price indefinitely into the future in the face of the current collapse in drilling activity is likely to be strong enough to keep overall prices from rising. In addition, the increased production of old gas (although less than projected by DOE) would be all the more important, since at such low prices very little new gas could be expected to be found and produced.

[83] *See also* KP&L *et al.* at 25-26.

[84] The allowance is 6¢ per stage of compression not to exceed 18¢, plus compensation for the cost of fuel or power to drive the compressor.

[85] *But see* Texas Eastern Transmission Corp. v. FERC, 769 F.2d 1053 (5th Cir. 1985, *cert. denied*, 106 S. Ct. 1967 (1986) (Permits recovery of fuel and power costs to operate compressors constructed prior to the NGPA).

thorization for producers to collect those allowances, this assumption allegedly was improper and may have resulted in a substantial overestimate of the overall supply response. AGA contends that EIA's May 1986 *Analysis of DOE's Notice of Proposed Rulemaking, Ceiling Prices: Old Gas Pricing Structure* (EIA Study) (at 22-25) demonstrates that where pipelines pay compression costs, producers are able to produce 46 percent of the gas which DOE claims will be produced as a result of the new ceiling price.

It is unclear whether the DOE study accurately accounts for compression allowances in calculating current abandonment pressures for the fourteen fields. However, even if it does not, the Commission does not believe that such an omission would significantly affect the reliability of the DOE Study. The Commission's regulations authorize producers to collect compression costs only when expressly authorized to do so by contract. The EIA study relied on by AGA indicates that producers actually collect compression costs with respect to only 28 percent of sections 104 and 106 gas subject to compression. Thus, even assuming that pipelines' payment of compression costs does bring about 46 percent of the production increase claimed by DOE, that 46 percent increase would occur in only 28 percent of the cases under present contractual arrangements. The alleged error in the DOE study, therefore, could at most cause an overestimate of increased production by 12.4 percent (28 percent of 46 percent equals 12.4 percent) assuming pipelines do not agree to bear a significantly greater percentage of compression costs than they now do.

Furthermore, the Commission does not believe that, even in those cases where pipelines assume compression costs, the supply response from the rule would be reduced by 46 percent. While the producer could charge the compression allowance in addition to the existing ceiling price, it could also charge the compression allowance in

addition to the new ceiling price.[86] Thus, to the extent DOE ignored compression allowances, it not only failed to take into account any additional production that the allowance permits under existing law, it also failed to take into account the additional production that the allowance would permit under the new price ceiling. The two factors largely offset one another.[87]

Finally, the Commission observes that while the EIA study predicts a supply response of 8.4 Tcf assuming all compression costs are borne by pipelines but 15.9 Tcf if they are borne by producers, EIA's overall predicted production increase is 11.7 Tcf, based on the fact pipelines assume compression costs only 28 percent of the time. That figure agrees very well with the DOE study's predicted 11 Tcf increase.

The third error alleged by AGA in DOE's calculation of increased production from the fourteen fields is DOE's use of unreliable reserve and pressure data. AGA asserts that DOE improperly used reserve data for each of the fields published in 1970; that data allegedly is so outdated, having been collected for example at a time when the average wellhead price was only 17¢, as no longer to be reliable. AGA also reiterates its earlier criticism of DOE for estimating pressures in each of the fourteen fields based on field depth and other factors rather than relying on actual measurements of field pressure. AGA's assertion that DOE used 1970 reserve figures is inaccurate. It is apparent from DOE's reply comments that, unlike the 1983 Shell study and the Indicated Producers'

[86] Based on the discussion above at page 67, the Commission believes that the market will generally permit such collection over the 20 to 40 year period of the predicted supply response.

[87] It should also be noted that the compression allowance is relatively small compared with price increases permitted by this rule. The allowance is only 6¢ per compression stage up to a maximum of 18¢ plus fuel costs. This compares to an increase in the ceiling price for pre-1973 gas, for example, from 52¢ to $2.57.

study, DOE used figures for reserves from a 1980 AGA study presented to Congress's Office of Technology Assessment (OTA) for its consideration in preparing a February 1984 report entitled *Effects of Decontrol on Old Gas Recovery*.[88]

More importantly, AGA has not shown that any inaccuracies in DOE's reserve and pressure data are significant enough to affect the essential conclusion that the increased production from the fourteen fields will be substantial. In its comments, AGA submitted a study using updated reserve data, actual field pressures, and an assumed \$1.90 market price for old gas to estimate the increased production from the fourteen fields. That study shows increased production of 2.3 Tcf, nearly half DOE's prediction of 5.7 Tcf. Such an increase, as the Commission observed in Order No. 451, would still be significant. Furthermore, the AGA study contains errors leading it to *underestimate* the probable increased production in the fourteen fields. As already discussed above, the AGA study improperly assumed a market price for old gas of \$1.90 rather than the new ceiling price. In addition, as fully discussed in Order No. 451, the AGA study used reserve and pressure data from different years causing a further underestimate of increased production in the fourteen fields.[89] In its rehearing request, AGA does not contest Order No. 451's criticism of its study on this basis.

The Commission has now considered all contentions raised on rehearing concerning increased production from the fourteen fields. None alter the Commission's belief that elimination of vintaging will cause a substantial increase in recoverable reserves in the fourteen fields.

Once increased production in the fourteen fields has been estimated there remains the task of extrapolating

[88] DOE reply comments at 4.

[89] *See* 51 Fed. Reg. at 22,192.

the fourteen field results to a national level and accounting for production that would occur in any event under existing incentives. DOE accomplished this task by a three step procedure. First, it extrapolated the fourteen field results to a national level by multiplying those results by the ratio of ultimate national reserves to ultimate reserves in the fourteen fields.[90] Next, DOE reduced its estimate of national increased production by four percent, in order to account for production which would have occurred in any event under existing section 108 incentive prices for stripper wells. Finally, in order to adjust for the 1983 Shell study's failure to account for other gas that would receive adequate prices to stimulate full economic production under current regulations, DOE scaled down its estimate of increased production by the ratio of DOE's estimate of the total reserves responsive to eliminating vintaging (66 Tcf) to Shell's (115 Tcf) or about 57 percent. Neither AGA nor other rehearing applicants attack the adjustment made in the first step of DOE's extrapolation procedure. However, they do attack the adjustments made in the second and third steps.

First, AGA claims that the stripper well adjustment is too small. It notes that 40 percent of all producing wells are stripper wells and that to date over 100,000 wells have qualified as stripper wells. AGA contends that these facts suggest that most section 104 and 106 wells will eventually qualify as stripper wells, thus providing the production response anticipated under Order No. 451 without collapsing old gas vintages.

AGA's contentions on this point are not persuasive. While the Commission can confirm that as of March 1986, over 100,000 wells have qualified for stripper well pricing under NGPA section 108 nationwide, over 50 percent of

[90] *See* 51 Fed. Reg. at 22,193 for a discussion of why use of the ratio of ultimate national reserves to ultimate reserves in the fourteen fields is appropriate for this purpose.

all such wells are located in a limited geographic area, in the Appalachian region of the country.[91] Moreover, the average daily production from these wells is extremely low, consertively estimated in most cases at fifteen Mcf per day or less.[92]

Thus, stripper wells are not for the most part located in areas where substantial reserves of old gas are located. The OTA study confirms that an unknown percentage of stripper applications are new, low production wells, and are not examples of how the stripper incentive has prolonged well lives.[93] In West Virginia, which accounts for almost one-quarter of all stripper wells, for example, producer filings since 1984 are generally made for WGPA section 103, with a later filing for a section 108 determination for the same well approximately three months later.[94] Thus, these wells are not

[91] Data on the number and location of NGPA section 108 stripper wells is derived from Forms 121 filed with the Commission. Of the over 100,000 stripper wells nationwide, about 11,000 are located in Ohio, 1,700 in New York, 26,000 in West Virginia, 13,000 in Pennsylvania, and 3,500 in Kentucky, for a total of 56,000 in the Appalachian region, or over 50 percent of all stripper wells.

[92] In 1983, the average daily per well production from a gas well in the States of Ohio, New York, West Virginia, Pennsylvania, and Kentucky was 15 Mcf, 19 Mcf, 14 Mcf, 13 Mcf, and 15 Mcf, respectively. Since stripper wells comprise approximately 62 percent of the total number of producing gas wells in these states, and the average per day per well production figures include other wells, the per day production from stripper wells is probably even lower. *See* Interstate Oil Compace Commision, The Oil and Gas Compact Bulletin, Vol. XLIII, No. 2 (Dec. 1984) at S-2 (United States 1983 Production of Oil and Gas by States).

[93] Office of Technology Assessment Staff Memorandum on the Effects of Decontrol on Old Gas Recovery, prepared by the Energy and Materials Program (Feb. 1984) at 50.

[94] Prior to 1984, before gas prices became extremely depressed, producers would more commonly file for NGPA sections 102 and 107 determinations, as well as section 103, and then later file for a section 108 determination for the same well after completing a 90-

old gas wells whose life has been prolonged by obtaining stripper well status, but instead are new, low-production wells. Even though we do not know precisely how many stripper wells are new wells nationwide, under current market conditions this is more likely to be the case than not.

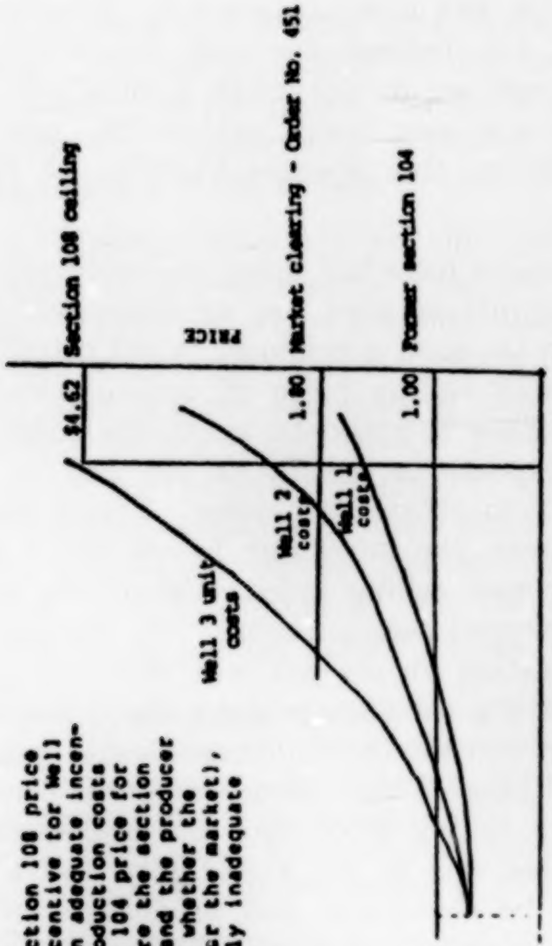
AGA's contention might have had more relevance prior to 1984 when market prices were not as depressed as they are currently. In the past, a producer might actually obtain the stripper well ceiling price of approximately $4.00 per MMBtu.[95] Thus it would be worth the administrative effort and expense to qualify an old well as a stripper well in order to obtain that price. Under current conditions, however, the purchaser is not likely to pay the full stripper well ceiling price, even if the old well obtains a stripper well determination.[96] In the past, when the cost of operating an old gas well exceeded the revenues generated at the old vintage price the operator may have continued production until the well could qualify as a stripper well because the operator knew it could obtain the section 108 ceiling price once the well qualified. In today's market this is not a certainty and the well will more likely be abandoned and production lost. (The diagram at the margin graphically illustrates this syndrome.) Plainly, the market, including consumers, producers, pipelines, distribution companies, and industrial end-users are better off with less new gas and more old gas that is now being abandoned if this additional

day production period in order to prove that the well did not exceed an average of 60 Mcf per production day, so as to meet the definition of stripper well natural gas under NGPA section 108(b). *See* Interstate Oil Compact Commission, The Oil and Gas Compact Bulletin, Vol. XLIV, No. 1 (June, 1985) at 51.

[95] $4.018 per MMBtu in August 1984.

[96] The stripper well ceiling price as of July, 1986 was $4.615 per MMBtu. Under current conditions it is unlikely a producer will receive anywhere near that price, however.

In this diagram, the section 108 price provides an adequate incentive for Well 1, may provide less than adequate incentive for Well 2 (the production costs exceed the NGPA section 104 price for an extended period before the section 108 price is obtained, and the producer may rightfully question whether the stripper price will clear the market), and provides a definitely inadequate incentive for Well 3.



(Diagram represents locus of supply costs for three old gas wells over time and several price/output relations; these are but three of the multitude of possible cost/output relationships. As pressure drops and production decreases over time, a higher price is needed to prevent abandonment. The NGPA section 108 price may not be the best economic incentive, since to qualify for this stripper well price, output must be no more than 60 Mcf/day (unless special ruling is obtained).)

"x" indicates production greater than 60 Mcf per day, declining, as time passes, until it reaches 60. The curved lines indicate the increase in per unit costs.

old gas can be acquired at a price below that of new gas. This is what the final rule will accomplish, which the mere availability of the section 108 price does not.

AGA also claims that DOE overestimated total national responsive reserves when it scaled down the predicted increase in nationwide recoverable reserves by the ratio of its estimate of responsive reserves to Shell's. Allegedly, this meant DOE failed to account sufficiently for Shell's overestimate of responsive reserves. As explained in Order No. 451, DOE calculated its 66 Tcf estimate of responsive reserves by (1) determining the percentage of each category of gas likely to respond to higher prices allowed by eliminating vintaging, (2) multiplying the amounts of gas in each category on December 31, 1980, by those percentages, and (3) totalling the results. In doing this, DOE relied on data in a study prepared for AGA.[97] AGA alleges DOE made two errors in performing this calculation.

First, AGA contends that DOE erred in including 10 percent of section 105 intrastate gas, or 3.9 Tcf, in responsive reserves. AGA argues that intrastate gas will generally be unaffected by Order No. 451 because most is deregulated and the remainder is either section 105 gas (intrastate gas sold under contracts existing on the date of enactment of the NGPA) not subject to Order No. 451 or is eligible for the higher NGPA section 102 price.[98] The Commission believes that some intrastate gas is properly included in the estimate of gas affected by Order No. 451, and that DOE's estimate of that amount is reasonable for the following reasons. Although Order No. 451 does not permit higher prices for section 105 gas, Order No. 451 does permit section 106(b) gas (intrastate gas sold under rollover contracts) to qualify for higher prices. All section 105 and 106(b) gas sold under contracts

[97] *See* DOE reply comments at 14.

[98] AGA at 16.

which provided for prices of $1.00 or less on December 31, 1984, remains subject to ceiling prices well below the alternative ceiling price provided by Order No. 451.[99] Thus, all gas presently subject to section 106(b) which was sold under such low-priced contracts is properly included in responsive reserves. So also is section 105 gas sold under such contracts if those contracts will expire in time to permit the gas to qualify for the alternative ceiling price before abandonment.

DOE's estimate of responsive intrastate gas does not include any present section 106(b) gas and to that extent may actually underestimate responsive intrastate gas. DOE does include section 105 gas sold under low-priced contracts which will expire by 1995 permitting the gas to qualify for the section 106(b) ceiling price. DOE appears to have reasonably estimated the amount of that gas. Based on EIA data, which AGA does not contest, DOE states that about 35 percent of intrastate old gas is sold under contracts which provided for prices of $1.00 or less on December 31, 1984. About 28 percent of these contracts will expire by 1995. Since 28 percent of 35 percent is about 10 percent, DOE concluded that 10 percent of intrastate gas (or 3.9 Tcf) may reasonably be considered responsive to the higher prices provided by Order No. 451.[100] The Commission finds the DOE calculation reasonable and rejects AGA's contention that intrastate gas should be excluded altogether from the responsive reserve base. In any event, the Commission observes that intrastate gas accounts for only 5.9 percent of the total 66 Tcf responsive reserve base found by DOE. Thus, even if DOE has overestimated the intrastate gas responsive to elimination of vintaging, the resulting error in the overall 11 Tcf estimate of increased production under Order No. 451 would be minimal.

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[99] *See* NGPA section 121(a)(3), 15 U.S.C. § 3331(a)(3) (1982).

[100] *See* DOE reply comments at 15.

AGA's second criticism of DOE's calculation of responsive reserves is that DOE failed to exclude all gas produced through 1985. Instead, DOE's calculation was based on December 31, 1980 reserves. AGA contends that gas produced or abandoned since 1980 should have been excluded since such gas is no longer available to be produced as a result of the elimination of vintaging. The Commission finds this criticism of DOE's calculation of responsive reserves without merit. In the first place, the increased production as a result of eliminating vintaging is, by definition, production which, because uneconomic, cannot occur under present ceiling prices. Thus, production of gas which is economic under present ceiling prices should not affect the increased production to be obtained through eliminating vintaging unless as a result the gas field is entirely abandoned. It follows that AGA is incorrect in suggesting that production since 1981 under existing ceiling prices reduced the increase in production from eliminating vintaging. Secondly, as explained in more detail in Order No. 451,[101] DOE properly used December 31, 1980 reserves in order to use consistent data in adjusting for the Shell study's overestimate of responsive reserves. The original Shell study had extrapolated the fourteen field results to a national level by multiplying those results by the ratio of January 1981 national reserves responsive to decontrol to January 1981 reserves in the fourteen fields. Shell had estimated January 1981 responsive reserves to be 115 Tcf. Since DOE scaled down its prediction of increased production by the ratio of its estimate of responsive reserves to Shell's 115 Tcf estimate and Shell's estimate was for January 1, 1981, consistency required that DOE use an estimate for the same period. If, as AGA suggests, DOE's estimate of responsive reserves should be reduced to account for production since 1980, then the Shell estimate should also be similarly adjusted so that consistent figures may be used in determining the ratio. If this were done, the ad-

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[101] 51 Fed. Reg. at 22,193.

justments to the two figures would probably approximately cancel one another out, leaving the ratio used to account for Shell's overestimate of responsive reserve approximately the same.

The Commission has now considered all contentions raised on rehearing alleging specific errors in the DOE study. While the Commission has rejected these contentions and continues to believe that the DOE study is the most reliable of the studies concerning supply response in the present record, the Commission wishes to emphasize that no estimate of the increase in recoverable reserves from this rule can be exact. As the Commission stated in Order No. 451, "Overall the only certainty about future natural gas supplies is their extreme uncertainty."[102] Any estimate of increased production under this rule must be based on predictions concerning future market prices and future behavior of producers and purchasers over the next twenty and more years which cannot be made with any certainty. For example, the DOE study is based on a prediction that market prices will rise to the new ceiling price. If they do not, the supply response will not be as great as predicted. In addition, the DOE study assumes that purchasers will not agree in the future to pay a higher percentage of compression costs than they now do. If, however, purchasers did agree to pay a higher percentage of compression costs, some of the supply response predicted by DOE from this rule would occur even if this rule were not adopted. On the other hand, DOE's 11 Tcf estimate of increased reserves does not include any increase in production from water-drive reservoirs as a result of this rule. However, some increased production from partial water drive reservoirs may occur. Some of those reservoirs may be susceptible to permanent loss of recoverable reserves when subjected to sharply curtailed takes of gas. It may well be that more favorable take provisions will be negotiated as a

[102] 51 Fed. Reg. at 22,194.

result of this rule that will permit an increase in the amount of in-place gas resources that will ultimately be recovered. Such higher rates of take and greater recovery of in-place reserves could moderate producer demands for a higher contract price because of the enhanced cash flow resulting from such increased takes.

Nevertheless, regardless of the uncertainties of predicting the precise amount by which recoverable resources will be increased by this rule, the Commission believes it clear that there will be a significant increase. There is a direct relationship between price levels and the length of time operation of a well remains economic. Since pre-1975 gas will receive a substantial price increase as a result of this rule, recoverable resources must also increase. This finding is supported by the fact that all the studies, including AGA's, agree that there will be a significant increase in recoverable resources.

Some rehearing applicants question the general conclusion that eliminating vintaging will substantially increase recoverable reserves. First, several petitioners[103] observe that there is curently a surplus of deliverable gas estimated as high as 2.49 Tcf for 1986. The petitioners claim that it makes little sense to expect additional production to occur during a time of surplus. The Commission disagrees with this contention. The increased production of old gas expected to occur as a result of this rule is from wells which are currently subject to ceiling prices ranging from 52¢ to $1.66 for large producers and 62¢ to $2.18 for small producers. Thus, Order No. 451 will permit much of this gas to receive substantial price increases, thereby making its production economic, and yet still permit it to undersell much gas that is already in the market. There is no reason not to expect such gas to find a market, even during a time of surplus. In any event, as discussed above, the surplus will not last in-

[103] Ohio Consumers Counsel at 7; Florida Cities at 20; Northwest Central at 41.

definitely, particularly in light of the current collapse in drilling activity and the Commission's action to create more competition.[104] DOE, for example, predicts that the surplus will be dissipated by 1988 under current regulation and 1987 if vintaging is eliminated.[105] Most of the increased production from eliminating vintaging will thus occur after dissipation of the surplus.

Some petitioners for rehearing contend that, even if the increased production of old gas occurs and causes overall prices to decline, this will discourage new drilling and result in the abandonment of many existing stripper wells.[106] They argue that over the longer term, the loan of stripper and some new gas production will offset, and thereby cancel out the benefits of, the increased old gas production. The Commission understands that under Order No. 451 some high-cost gas may not be produced immediately in the same time frame as under current regulations because of lower prices in the near term for such gas although the Commission would expect that renegotiation to lower prices will cause some portion of higher priced gas to be produced and sold at lower prices as has occurred in the current market. Exploration for and development of other higher-cost new gas will be delayed. However, these are precisely the intended ef-

[104] The Commission notes that after the Commission issued Order No. 451, the Energy Information Administration (EIA) released the advance summary of its year-end report on the U.S. natural gas reserves. EIA's data indicates overall, natural gas reserve additions in the lower-48 states declined to 77.9% of production in 1985, and U.S. proved gas reserves declined for the fourth year in a row. *See* U.S. Department of Energy, Energy Information Administration, Advance Summary of U.S. Crude Oil, Natural Gas, and Natural Gas Liquids Reserves, 1985 Annual Report (Washington D.C., September 1985).

[105] The overall lower prices brought about by the rule will cause the surplus to dissipate faster than it otherwise would.

[106] Elizabethtown Gas Company (Elizabethtown) at 5; KP&L *et al.* at 25; Florida Cities at 31; AGA at 13; and APGA at 44.

fects of Order No. 451 which will cause overall prices to be less than they otherwise would be. The increased supply of lower-cost old gas will replace some higher cost gas immediately and delays the need to engage in expensive exploration and development of high-cost new gas.

Finally, some rehearing requests reiterate the contention that, even assuming increased production of old gas occurs, it will not be beneficial since its incremental cost will be exorbitant.[107] In response, the Commission reiterates its rationale for rejecting this contention in Order No. 451. The high incremental cost estimates are obtained by determining the purchasers' increased cost of purchasing all old gas as a result of Order No. 451 and dividing the result by DOE's estimate of increases in recoverable reserves. This calculation fails to take into account the reduction in price of high-cost gas which will occur as a result of this rule. The petitioners' contentions that higher cost gas will not come down in price as predicted by the Commission are considered in the next section.[108]

[107] Peoples Gas *et al.* at 13; Cal. PUC at 6; NI-Gas at 13; Florida Cities at 25; AGD at 4; UDC at 42; and Northwest Central at 25, 40.

[108] The Citizen/Labor Energy Coalition (C/LEC) at 4-6 contends that Order No. 451 improperly relied on the May 1986 EIA Study in its findings concerning the supply response. This applicant states that the EIA Study's supply response estimate relied heavily on full implementation of Order No. 436. Without the transportation rights provided by full implementation, the supply response allegedly would decline significantly. It is, of course, true that producers must be able to obtain transportation of their gas in order to obtain the full benefit of the market-responsive pricing permitted by this rule. However, even if Order No. 436 is not adopted by every pipeline, the transportation provisions of Order No. 451 should enable producers to obtain the necessary transportation. Second, the applicant states that the Commission's failure to adopt DOE's proposal for incentive prices would reduce the supply response projected by EIA. However, that failure can have no effect

E. *Price Response*

In Order No. 451, the Commission considered the comments and data in the record regarding the likely impact of the DOE proposal on consumer gas prices and pipelines' weighed average costs of gas (WACOGs). The Commission concluded that the most likely impact would be further downward pressure on consumer prices and WACOGS. It found that the higher ceiling price for old gas would eliminate the price distortions of the old gas cushion. It also found that the higher ceiling price would lead to a reduction in wellhead prices for high-cost gas to market-clearing levels responsive to competition mandated by the NGPA.[109]

The Commission also concluded that, over the long-run, pricing old gas at its replacement cost would call forth additional supplies of gas not likely to be available under vintage pricing, and that these additional supplies would put downward pressure on future wellhead prices.[110] In analyzing the numerous studies and statistics in the record and in the public domain [111] concerning the likely price impact of the DOE proposal, the Commission stated that the real issue was not *whether* over-

on the EIA Study's prediction of an 11.7 Tcf supply response through delayed abandonment. Finally, the Commission notes that in any event it does not rely on the EIA Study in its holdings concerning the supply response except to the extent applicants themselves have relied on the EIA Study to challenge the Commission's holdings.

[109] *See, generally,* Order No. 451, 51 Fed. Reg. 22,195-204 (June 18, 1986).

[110] *Id.* at 22,197-98.

[111] *See* Foster and Reddick, "Analysis of High Cost Gas Purchases by Contract Termination Date," *Gas Energy Review* (Vol. 13, No. 12, American Gas Association, December 1985); AGA Initial Comments, "1986 Base Case, U.S. Energy Information Administration, Analysis of Natural Gas Contracts, Volume I: Old Interstate Gas," *Service Report,* Table 3 (February 1986) (RNGD-86-01).

all gas prices would come down in response to higher old gas prices, it was *how fast* such prices would come down. Based on the record as well as on the behavior of pipeline purchased gas costs (PGAs) before and after the partial deregulation of wellhead prices on January 1, 1985, the Commission concluded that any renegotiation of old gas prices to replacement cost levels under the DOE proposal would be more than offset by reductions in high-cost gas prices.[112]

However, the Commission also found that, despite the likely reduction in overall gas prices, it was impossible to predict with certainty whether some consumers or some pipeline systems would face short term transitional increases in their gas costs before the lower overall prices and enhanced supplies are made available to all pipelines under the rule. For this reason, the Commission modified the good faith negotiation procedure in the final rule in order to give the purchaser the right to renegotiate the prices of all gas, including new gas, in contracts which contain some old gas where the producer requests any old gas price renegotiation. Under this modification, the American Gas Association (AGA) estimated that at least one-third of all new gas potentially would be subject to price renegotiation by purchasers, because it is contained in "multi-vintage" contracts which cover some old gas eligible for renegotiation to the new ceiling price established by the final rule.[113] To the extent large quanities of this new gas, as well as high-cost categories of old gas, are already priced above spot market prices or individual pipeline WACOGs, Order No. 451 concluded that the modifications to the good faith negotiation procedure would give pipeline purchasers substantial added leverage to bargain both old and new gas prices to market-responsive levels.

[112] Order No. 451, 51 Fed. Reg. 22,198-203 (June 18, 1986).

[113] AGA at 4.

Finally, the Commission included two additional protections in Order No. 451.

First, the Commission provided to firm sales customers of a pipeline a right of first refusal to any old gas released by the pipeline to the open market as a result of unsuccessful price renegotiation. This right of first refusal would assure that those customers with least access to alternative gas supplies—especially sole-supplied, full-requirements customers of pipelines that have not chosen to provide open access transportation under Order No. 436—would have the ability to keep inexpensive old gas supplies on-system by matching any bids for the gas released to the open market.[114] In addition, the final rule provides such customers (and others) with transportation authority in order to receive the gas.

Second, the Commission stated its intention to assure that the PGAs reflect prudent renegotiating practices by pipelines under the rule, instead of projecting purchased gas costs based on the worst possible outcome of such renegotiaton.[115] This scrutiny would assure that pipelines cannot choose to pass through to their customers any higher old gas prices requested by producers without exercising their bargaining rights under the good faith negotiation procedure.[116]

For these reasons, the Commission concluded that Order No. 451 would not unreasonably increase consumer gas

[114] Order No. 451, 51 Fed. Reg. 22,207 (June 18, 1986).

[115] In a recent PGA filing by Colorado Interstate Gas Company, for example, the Commission rejected CIG's estimate of the net effect of impending negotiations under Order No. 451 and disallowed recovery of projected gas cost increases for lack of adequate supporting data. 36 FERC ¶ 61,406 (1986). The Commission took similar action with respect to a PGA filing by KN Energy, Inc. which also included an estimate of the net effect of Order No. 451. 37 FERC ¶ 61,198 (1986).

[116] *Id.* at 22,203.

prices over the short-term, and over the long-term reduce city-gate gas prices in response to more competitive wellhead markets and enhanced supplies.[117]

Requests for Rehearing. On rehearing, a number of pipelines, distribution companies, and their trade associations argue that the Commission lacked substantial evidence in the record to determine the impact of the final rule on pipeline WACOGs and consumer prices.[118] These applicants state that the final rule is based on economic theory, not credible evidence, and that there will be substantial pressure on pipelines to bid the highest price for old gas under the rule, because wellhead markets are not workably competitive.[119]

INGAA, AGA, and most pipelines acknowledge that, by including multi-vintage contracts in the renegotiation process, Order No. 451 gives partial recognition to the problem of high-cost new gas contracts. However, they criticize the final rule as being inadequate to remedy the whole problem, because it does not give purchasers the right to bring all gas contracts to the bargaining table.[120] Texas Eastern, Transco, and others argue the final rule will increase old gas prices without forcing high-cost gas

[117] *Id.* at 22,204.

[118] *See, e.g.*, INGAA at 9-11; UDC at 37; Panhandle Eastern Pipe Line Company, Trunkline Gas Company, and Trunkline LNG Company (Panhandle and Trunkline) at 4-5; Florida Cities at 23-24; Northern Natural at 26-32; Southern Natural at 5.

[119] *See, e.g.*, Northwest Central at 2-4; AGD at 10; APGA at 35-45; Northern Natural at 32.

[120] *See, e.g.*, INGAA at 10-11; AGA at 28-29; Northwest Pipeline Corporation at 4; ANR Pipeline Company and Colorado Interstate Gas Company (ANR and CIG) at 9; Natural and United at 2, 7; Transwestern Pipeline Company (Transwestern) at 4; Arkla Inc. (Arkla) at 10-11; Northern Natural at 37; Transcontinental Gas Pipe Line Corporation (Transco) at 4-6; Florida Gas Transmission Company (Florida Gas) at 4, 18-19; Texas Gas Transmission Corporation (Texas Gas) at 5; Texas Eastern at 4-5.

prices down, unless purchasers are given the right to initiate renegotiation of high-cost gas contracts which do not cover some old gas.[121]

Several applicants argue that the final rule will only force pipelines to reduce takes of high-cost gas, thus increasing the take-or-pay costs associated with such contracts. The problem, these applicants say, is not low old gas prices, it is take-or-pay costs.[122] Other applicants allege that the recent decreases in pipeline WACOGs cited in the final rule are largely due to pipelines exercising market-outs and maximixing old gas takes, and that the only high-cost gas contracts remaining are those with rigid, non-market-responsive terms not susceptible to market pressures if old gas prices increase.[123]

A number of applicants argue that the inclusion of multi-vintage contracts in the good faith negotiation procedure will not help "deep cushion" pipelines—those pipelines with large quantities of cheap old gas and very little high-cost gas under the same or other contracts. Notwithstanding any overall reduction in gas prices nationwide, applicants say, these pipelines face inevitable price increases under Order No. 451, because they lack enough high-cost gas to offset against old gas price increases sought by their suppliers.[124]

Some applicants argue that producers will never initiate price renegotiation of their old gas unless they believe that higher prices are available in the marketplace

[121] *See, e.g.*, Transco at 6-7; Texas Eastern at 17-19.

[122] *See, e.g.*, AGD at 8-9; Peoples Gas *et al.* at 8-9; UDC at 52; INGAA at 12-15; APGA at 37-40.

[123] *See, e.g.*, INGAA at 11, AGD at 8-9; MPC NASUCA at 28-30; NI-Gas at 8-12; N.Y. PSC at 15-16; Tennessee Gas Pipeline Company (Tennessee) at 10-13.

[124] *See, e.g.*, Northern Natural at 34-36; Interstate Power Company at 4; Midwest at 1-3; Northwest Central at 45; KP&L *et al.* at 20; Kentucky Public Service Commission (Kentucky PSC) at 2.

for all their gas subject to renegotiation, regardless of whether or not their pipeline purchaser exercises its renegotiation rights. Thus, these applicants say, the final rule guarantees higher prices unless purchasers are permitted to initiate price renegotiation on their own.[125] Similarly, some applicants argue the Commission cannot have it both ways: increased gas supplies cannot result without higher prices to consumers, and lower consumer prices cannot occur without reducing supplies.[126]

On the other hand, some pipelines, distribution companies, trade associations, and state commissions agree with the Commission's conclusion that wellhead markets are workably competitive, or otherwise laud the Commission's goal of raising the ceiling price for old gas to market-clearing levels.[127]

Producer applicants generally agree that under current competitive conditions in wellhead markets, the higher old gas ceiling price will bring prices down to market-clearing levels.[128] But producers argue that the inclusion of multi-vintage contracts is unnecessary to achieve this goal. In support of these conclusions, these applicants cite the experience of wellhead markets under partial deregulation and argue that market forces are forcing renegotiation of high-cost, take-or-pay contracts through the good faith negotiation procedure. Producers also point out that including new gas in the good faith negotiation procedure is unwarranted because issues re-

[125] *See, e.g.*, INGAA at 11; Transco at 4; Pacific Gas and Electric Company (PG&E) at 2, 4; Arkla at 5, 8-10.

[126] *See, e.g.*, Florida Cities at 23-24; Ohio Consumers Counsel at 6-8.

[127] *See, e.g.*, Transco at 4; Cal. PUC at 23-27; El Paso Natural Gas Company (El Paso) at 1-2; Baltimore Gas and Electric Company (BG&E) at 1; Process Gas Consumers Group, American Iron and Steel Institute, and Georgia Industrial Group (PGC) at 2.

[128] *See, e.g.*, Indicated Producers at 2.

lating to take-or-pay and new gas prices would be brought to the bargaining table voluntarily anyway.[129] Finally, producers generally agree that Order No. 451 will go far in removing a primary source of current price disorders in natural gas markets—the "price cushion" created by existing old gas vintage price ceilings.[130]

Maryland People's Counsel and the National Association of State Utility Consumer Advocates (MPC/NASUCA) allege that Order No. 451 will not reduce gas prices because the natural gas industry—including the pipeline segment—is not workably competitive in the absence of meaningful access to transportation. The fact that the wellhead market may be competitive does not mean that the entire industry is competitive, MPC/NASUCA say. Therefore, without transportation access, local distribution companies and consumers will have no alternative to increased old gas costs passed along by pipelines under Order No. 451. MPC/NASUCA also allege, as discussed *supra* in IV. B., that the previous price distortions of the old gas "cushion" have been largely eliminated, and that the current WACOGs of pipelines that enjoyed a cushion are no longer below market-clearing levels and that such pipelines no longer retain artificial advantages over other pipelines in bidding for new gas.[131]

A group of industrial end-users commands the Commission for expanding the scope of the rule to cover multi-vintage contracts, but argues that any old gas price increases should be tied to reductions in high-priced new gas over the same period of time, in order to

[129] *See, e.g.*, Indicated Producers at 4-8.

[130] *See, e.g.*, Independent Petroleum Association of America (IPAA) at 1; Indicated Producers at 2-7.

[131] MPC/NASUCA at 17-26.

avoid any short-term increases in the price of gas on certain pipeline systems.[132]

Florida Cities argue that if the Commission is correct in its finding that wellhead gas markets are competitive, then any increase in old gas prices under Order No. 451 will be matched by a decrease in new gas prices, and the consumer will get no price benefits under the rule.[133] In support of this view, Florida Cities cite the Commission staff's findings in the 1982 Notice of Inquiry on wellhead price issues, as well as a study commissioned by the Natural Gas Supply Association (NGSA).[134] Similarly, AGD argues that contract rigidities, not low old-gas prices, are the real source of gas market distortions, citing the Commission's own conclusions in Order No. 436.[135] Finally, INGAA and others allege that Order No. 451 will increase cash flow to producers, and therefore reduce, not increase, their incentive to renegotiate high-cost problem contracts.[136]

Commission Response. Many of the applications for rehearing on the price response issue appear to misunderstand the Commission's fundamental purpose in promulgating the final rule. As the Commission stated:

> It is clear that consumers have suffered shortages and higher prices under the current price system for old gas, and these distortions can only cause more damage to consumers in the future, if existing reserves continue to be sold on a basis less than replacement cost. Keeping old gas rates below replacement cost can only revive shortages and high prices for future generations of consumers.

[132] *See, e.g.*, PGC at 12-14.

[133] Florida Cities at 2-3.

[134] *Id.* at 23-24.

[135] AGD at 8.

[136] INGAA at 10; Kentucky PSC at 2; N.Y. PSC at 16.

> The final rule is not only intended to balance the interests of present consumers and present producers, it is intended to balance the needs of future consumers for long-term reliable gas service, with the protection of present consumers from exploitation by producers.[137]

For this reason, Order No. 451 does not guarantee a particular wellhead price for old gas to either producers or pipelines. Instead, it leaves to both parties the opportunity to renegotiate old gas prices subject both to the full competitive conditions in wellhead markets mandated by the NGPA *and* to the protection of a just and reasonable price ceiling. In this way, in times of surplus, such as now, old gas prices are likely to fluctuate below the price ceiling and possibly below long-term replacement costs. In times of adjustment as supply and demand move into equilibrium, old gas prices may move higher, but never in excess of the new ceiling price. Under the rule's renegotiation requirement, the Commission has assured that short-term price impacts, if any, are subject to the consent of individual pipeline systems, rather than be incurred suddenly by virtue of the automatic operation of indefinite price escalators in existing contracts.

To the extent old gas prices will be gradually renegotiated under Order No. 451 to market-responsive levels, the Commission and most applicants agree the prices will more closely approximate the replacement cost of all gas. However, to the extent the previous old gas vintage pricing system has permitted a small minority of interstate pipeline systems to artificially maintain their overall gas prices below even today's depressed spot market prices, Order No. 451 is in no way intended to exempt such pipelines—or their customers—from the pressures in the marketplace to renegotiate their prices upward to competitive levels.

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[137] Order No. 451, 51 Fed. Reg. 22,203 (June 18, 1986).

On the contrary, Order No. 451 is expressly intended to remove the artificial price advantages these pipelines and their producer suppliers have enjoyed in the past and to instead require them to gradually renegotiate their prices under open market conditions, even if those market conditions may place upward pressure on their WACOGs. The Commission recognized in Order No. 451 that a small number of these pipelines could face gas price increases during a transition period, but that these price increases would not be unreasonable in light of the overall benefits of the rule. For this reason, the Commission rejects those applications which request the rule be modified to guarantee somehow that *no* pipeline will face *any* increased wellhead gas prices under Order No. 451. To guarantee no wellhead price increases whatsoever would undermine the fundamental purpose of the rule, which is to assure that old gas prices will more accurately reflect market clearing prices and thus reduce the previously distorting effect of the old gas vintaging system.

The crux of the price response issue on rehearing, then, is not whether any pipelines and their customers will face higher gas costs, but whether or not any such increases will be unreasonable.

Applicants generally concede that the inclusion of multi-vintage contracts in the "good faith negotiation" procedure will limit substantially the number of pipelines who will be exposed to increased old gas prices without any corresponding "right" to reduce other gas prices. However, applicants variously argue that (1) some pipelines do not possess enough high-cost gas under multi-vintage contracts to offset old gas price increases; (2) some "deep cushion" pipelines do not possess enough high-cost gas to offset against old gas price increases, regardless of multi-vintage contracts; or (3) even if pipelines possess enough high-cost gas, their producers will not initiate old-gas price renegotiation unless they are sure they can obtain higher prices for all their gas, in-

cluding take-or-pay payments for high-cost gas which the pipeline can terminate purchasing under the rule. Therefore, applicants conclude, pipelines and customers inevitably will face unreasonable price increases or lost supplies or both.

In response to these alleged problems, the Commission has reviewed the American Gas Association's (AGA) rehearing application, which included as Appendix A a study entitled "Economic Impacts of Order No. 451." [138] Appendix A analyzed data available to the public on gas contracts between major pipelines and major producers compiled by the Energy Information Administration from FERC Purchased Gas Adjustment Filings covering the first half of 1986. The data indicate for each pipeline the total amount and average contract price of old gas from each producer and the total amount and average contract price of any new gas covered by the same old gas contract. EIA also reports the total volumes and average price for both old and new gas covered by these contracts

[138] Rehearing Petition of American Gas Association, Appendix A, attaching "Economic Impacts of Order No. 451" Docket No. RM86-3-000 (July 3, 1986), (Issue Brief 1986-24); also see "AGA Forecasts Lower Gas Prices for this Winter," *Washington Letter* (American Gas Association, October 31, 1986) ("The nationwide average price of natural gas to residential customers this winter is forecast to be 6 percent lower than the price last winter, $5.28 per MMBTu versus $5.60 per MMBtu, according to an AGA analysis . . . The projection is based on an analysis of PGA filings made with FERC by 25 interstate pipeline companies representing about 95 percent of interstate gas purchases. According to AGA, the PGAs show that, on a nationwide average basis, the price pipelines will pay to buy gas this winter will be 32 cents per MBTu lower than last winter. Analysis of pipeline tariff data indicates that this saving will be passed on to the distribution companies. The average field purchase price projected by the pipelines for this winter is $2.14 per MMBtu, compared with $2.46 per MMBtu last winter, according to the analysis. While average costs vary from one pipeline to another, most systems expect price declines this winter, says AGA").

as well as the total volumes and average price for all contracts with each producer.

Appendix A then asumed a market price of $1.80 per MMBtu, which AAG said is in line with a benchmark refiner acquisition cost of crude oil of $17.50 per barrel and with trends in the spot gas market where prices are generally below $1.50/MMBtu—in some cases below $1.25/MMBtu. The assumed price was also in line with recent market-out prices by interstate pipelines, according to AGA.

For Order No. 451 as formulated, Appendix A also assumed that producers would nominate contracts to only those pipelines where the price of gas flowing under *all* old gas and multi-vintage contracts is less than the assumed $1.80/MMBtu market price. Given that the producer can nominate at any time, AGA said, it is unreasonable to assume that a producer would nominate to any pipeline where, in the aggregate, its average price for all contracts with old gas is above current market prices.

Appendix A also apparently assumed that once a producer nominated its contracts to a pipeline, the pipeline would agree to pay a price for the gas equivalent to the assumed market price, regardless of whether the gas is surplus to the pipeline's system supply needs. Another apparent assumption is that the price of new gas not covered by multi-vintage contracts nominated by a producer will not come down in response to the upward pressure on old gas prices. However, AGA does note recent trends in pipeline purchases indicating that anticipated WACOGs have been reduced from a $2.52/MMBtu average in early 1986 to $2.30 MMBtu at mid-year, due to reductions in takes of new, high-cost gas. In addition, AGA notes that if the market price of gas is in fact lower than the assumed $1.80/MMBtu, the impacts of Order No. 451 would be less than those calculated in Appendix A because fewer volumes of gas would be nominated for renegotiation by producers.

Based on all these assumptions, Appendix A concludes that average pipeline gas costs would be at least $0.08/MMBtu (3%) higher in 1986 than they would otherwise be—a WACOG of $2.60/MMBtu compared to $2.52/MMBtu. According to AGA, this increase would vary significantly among pipeline systems, depending primarily on the amount and price of old gas under contract to each system. Some pipelines would be minimally affected, because their contracts with producers have average prices higher than the current market level. Other pipelines with proportionally more low-cost old gas under contract, could expect their WACOGs to rise as much as $0.53/MMBtu (over 30%), according to AGA.

The Commission has also reviewed the PGA data for the first half of 1986 which underlies AGA's Appendix A. These data, excerpts of which are attached as Appendix B to this order, indicate that 16 of 20 major interstate pipelines have weighed average costs of Order No. 451-eligible, unaffiliated old gas and multi-vintage gas above $1.80/MMBtu. Of the remaining 4 pipelines with WACOGs of unaffiliated old and multi-vintage gas below $1.80/MMBtu, two (Northern Natural) at $1.63/MMBtu and Transwestern at $1.72/MMBtu) serve end-use markets which are subject to either intense interfuel competition (Transwestern)[139] or surplus system supplies

[139] The Commission rejects the contention of the California PUC that Order No. 451 will cause substantial increases in the WACOGs of Transwestern and El Paso, the two interstate pipelines serving California. El Paso's WACOG is even less likely to increase significantly than Transwestern's since the average price of its unaffiliated old gas is $2.12, substantially above AGA's assumed market price of $1.80. The seven California PUC estimates of potential increased annual costs to California consumers under Order No. 451, which range from 79 to 501 million dollars based on varying assumptions concerning the prices of old and multi-vintage gas, all underestimate the ability of purchasers to reduce the price of new, multi-vintage gas under Order No. 451. The estimates assume that the price of new gas in multi-vintage contracts will either (1) not be renegotiated at all, (2) be renegotiated only down to

(Northern). Both pipelines have settlements pending before the Commission under which their customers and shippers would be provided open access to alternative suppliers consistent with Order No. 436.

One pipeline (KN Energy at a WACOG of $1.11/MMBtu for eligible old and multi-vintage gas) has as its largest old gas supplier a former affiliate which was spun off recently to KN's common shareholders (Plains Petroleum Corporation). On October 1, 1986, KN filed its regularly scheduled annual PGA which proposed an increase of only 11.83¢/MMBtu in its average purchased gas cost over the next twelve months relating to the net effects of Order No. 451, market-outs, and a decrease in purchases associated with Cities Service. Because KN did not provide adequate support for the projection, the Commission accepted and suspended the PGA increase contingent on KN eliminating the Order No. 451 adjustment without prejudice to KN filing an out-of-cycle PGA with detailed support. 37 FERC ¶ 61,198 (1986).

The final pipeline (Northwest Central with an old and multi-vintage gas WACOG of $1.19/MMBtu) could offset over two-thirds of any old gas price increase to $1.80/MMBtu, by reducing its new gas WACOG from a current $3.63/MMBtu to $1.68/MMBtu, its current all-gas WACOG. This is also a large percentage reduction, but the Commission considers it unlikely that Northwest Cen-

$3.00, or (3) be renegotiated down to $2.58, the new ceiling price, while all old gas is renegotiated up to that ceiling price. However, the purchaser has the right, once the producer seeks a higher price for any old gas, to request that the producer nominate a new price for new gas in multi-vintage contracts or above-market old gas. The purchaser may abandon purchases of such gas if dissatisfied with the price nominated. Given these rights, it seems totally unrealistic to assume that pipelines will continue to pay prices substantially above the current market price of approximately $1.80 for new gas in multi-vintage contracts (or old gas) when the producer seeks a higher price for below-market old gas.

tral's old gas suppliers will be able to sustain price increases in excess of their pipeline purchaser's all-gas WACOG of $1.68/MMBtu. In addition, Northwest Central and its customers apparently recognize the substantial bargaining leverage contained in a right of first refusal such as that given a non-Order No. 436 pipeline's customers under Order No. 451.[140]

The Commission considers it reasonable to conclude that a pipeline experiencing a substantial contraction of its sales demand, as most have since 1982, will have additional bargaining leverage with its old gas producers, especially where its firm sales customers rely on the pipeline's system supply, and interconnecting pipelines have experienced a similar reduction in their sales demand.[141]

The Commission therefore rejects the assertion of the rehearing applicants that pipelines and their customers do not possess enough high-cost gas on their system, whether under multi-vintage contracts or not, to offset old gas price increases. The Commission believes that producers will nominate their old gas contracts cautiously and gradually, consistent with the risks they face in exposing their current old and multi-vintage contracts to the uncertainty of spot wellhead markets in the midst

[140] *See* Northwest Central's Order No. 436 settlement proposal, Docket Nos. RP86-32-000, RP86-68-000, where Northwest sought to reserve the right to defer implementation of the settlement if Order No. 451 is not modified to give a right of first refusal to Order No. 436 pipelines.

[141] In order to assist pipelines in renegotiating their contracts in such situations, the Commission has at certain pipelines' request, authorized blanket limited-term abandonment by the pipeline's suppliers. *See* Southern Natural Gas Co., 36 FERC ¶ 61,401 (1986), and Transcontinental Gas Pipe Line Corp., 36 FERC ¶ 61,403 (1986). Such authority provides pipelines additional flexibility to voluntarily renegotiate high-cost as well as low-cost jurisdictional gas as an alternative to renegotiation under the good faith negotiation rule.

of surplus deliverability and post-NGPA gas-on-gas competition in end-use and city-gate markets. Because of these competitive market conditions, the Commission also concludes that it is likely that old gas price renegotiation on individual pipeline systems will follow the pace of changes in the pipeline's overall WACOG, neither faster nor slower.

The Commission also rejects the allegation by applicants that producers will not initiate old gas price renegotiation unless they are sure they can obtain higher prices for all their gas. This is a circular-argument that old gas prices will not be market-responsive because producers will not seek higher prices unless they perceive that the market is willing to pay those prices. In any case, this argument does not alter the requirements of Order No. 451 that old gas prices be the price negotiated in light of market conditions or the ceiling price, *whichever is lower.*

The objection that Order No. 451's price response consideration is based on economic theory, not substantial evidence, must likewise be dismissed. Applicants' own numerous references to PGA data themselves confirm the downward flexibility of WACOGs since January 1, 1985, and belie the assertion that WACOGs will not be similarly flexible under Order No. 451. The Commission also notes that this WACOG flexibility will only increase as most pipelines elect to offer open access transportation under Order No. 436. The transitional transportation provisions in Order No. 451 assure the availability of this increased flexibility to all pipeline customers, regardless of their status under Order No. 436.

However, the Commission reiterates that it intends to strictly scrutinize pipeline PGAs filed to reflect Order No. 451 price negotiations, in order to monitor closely pipelines who bid the highest price for old gas without exercising their renegotiation rights under the rule. The Commission retains the ability, on a case-by-case basis,

to determine the prudence of pipelines' purchasing practices under the rule.

MPC/NASUCA's assertion that Order No. 451 will increase gas prices unless transportation access is available, must be dismissed.[142] Order No. 451 contains a transitional transportation provision and a right of first refusal which together provide access to transportation even where a pipeline is not an Order No. 436 transporter.[143] In addition, Order No. 451 expressly finds that any unduly discriminatory refusal by a pipeline to provide transportation for old gas released under the rule would constitute a violation of section 5(a) of the Natural Gas Act.[144]

In response to Florida Cities' allegation that Order No. 451 will only transfer income from one group of producers to another without increasing supplies, the Commission reiterates its finding that, over the long-term, the higher ceiling price for old gas will call forth additional old gas supplies as supply and demand move into equilibrium in gas markets. But for the new ceiling price, natural gas markets could face more cycles of boom and bust in the drilling industry such as those that have led to low reserve replacement ratios and shortages to consumers in the past.

In respose to INGAA, AGD, and others alleging that by failing to deal with take-or-pay, Order No. 451 addresses the wrong problem, and contradicts the Commission findings in Order No. 436, the Commission refers applicants to numerous notices of inquiry, proposed and final rules and other orders. Substantial evidence has been presented in all these other dockets as well as in this rulemaking regarding the continuing market distortions

[142] MPC/NASUCA at 17-26.

[143] Order No. 451, 51 Fed. Reg. 22,111-13 (June 18, 1986).

[144] *Id.* at 22,112-13.

caused by below-market vintage price ceilings for old gas.[145] The Commission therefore must reject the argument that Order No. 451 does not address a real problem in gas markets. Furthermore, the Commission believes that, as a general matter, purchasers can, and are, successfully renegotiating high-cost gas contracts with inflexible take-or-pay clauses. Adoption of Order No. 451 should accelerate that process. As the Commission observed in Order No. 451, an NGSA survey of producers shows that they have settled over two thirds of their outstanding take-or-pay liabilities and that most of the remaining liability is of recent origin. Also on NGSA survey of interstate pipeline financial statements filed with the Securities and Exchange Commission shows pipelines repeatedly stating that they expect to renegotiate take-or-pay contracts. Furthermore, an AGA study, submitted with its initial comments and later updated, projects that natural gas markets will force high-cost "market unresponsive" gas prices down 11% a year between 1984 and 1988.[146]

The elimination of vintaging can only accelerate this process. Pipelines will be able for the first time to offer higher prices for old gas in return for voluntary renegotiation of take-or-pay contracts. Furthermore, since the old gas cushion currently protecting high-priced contracts through rolled-in pricing will be eliminated, both pipelines and producers will find it mutually advantageous to renegotiate such contracts in order to retain a market for their supplies in the face of competition from cheaper gas

[145] *See, e.g.*, Order No. 451, 51 Fed. Reg. at 22,175 nn. 60, 61, and 63. *See also*, DOE Proposal, 50 Fed. Reg. 48,540 (Nov. 25, 1985), Interstate Transportation of Gas for Others, 50 Fed. Reg. 114 (Jan. 2, 1985) Notice of Inquiry (NOI); Natural Gas Pipeline Ratemaking, Risk, and Financial Implications After Partial Wellhead Decontrol, 50 Fed. Reg. 3801 (Jan. 28, 1985) (NOI, Phase II); Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, 50 Fed. Reg. 24,130 (June 7, 1985).

[146] 51 Fed. Reg. at 22,197 and 22,202.

and alternate fuels. Presumably, a producer would rather sell gas than have its wells shut in, because the pipeline cannot market the gas under the terms of their original contract, or go through the difficulty of a lawsuit to enforce an uneconomic contract.[147] It appears therefore, that purchasers have sufficient bargaining power to bring down the price of high-cost gas sold under take-or-pay contracts. Order No. 451 further reinforces that power with respect to such gas sold under multi-vintage contracts containing old gas by permitting the purchaser to request that the producer nominate a new price for any gas in such contracts and permitting the purchaser to discontinue purchases if dissatisfied with the producer's nominated price. Furthermore, it is conceivable that successful price negotiation pursuant to or as a result of Order No. 451 of the higher price gas will make the prices more competitive for resale, thus increasing the volume sold and reducing the pipeline purchaser's exposure to potential take-or-pay liability under such contracts. At the same time, however, the Commission does recognize that Order No. 451's substantial downward pressure on high-cost gas prices may expose certain pipelines to some additional liability for take-or-pay pre-payments for gas not taken under certain specific contracts. The Commission also expressly reaffirms its policy to expeditiously review take-or-pay "buyouts," including such "buyouts" under contracts subject to Order No. 451, in order that the parties may adjust to these new competitive pressures as smoothly as possible.

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[147] There are often considerable pressures on the producer to produce and sell its gas. In addition to the obvious needs to cover costs, debts, and royalty payments, there is often the risk that a failure to produce will cause the producer to lose the ability to recover the gas or make future recovery more expensive. Water can seep into nonproducing wells, and if the well is in a jointly-owned field an individual producer's show can "drain away" toward other producing wells.

In Order No. 436, we reaffirmed our earlier policy statement on "Regulatory Treatment of Payments Made in Lieu of Take-or-Pay Obligations," and indicated that pipelines may seek to recover take-or-pay buyouts in rate filings under section 4 of the NGA on a case-by-case basis.[147a]

For all these reasons, the Commission denies rehearing on the price response issue, and reaffirms its conclusion that Order No. 451 is unlikely to cause any unreasonable increase in gas prices to consumers or pipelines.

F. *Good Faith Negotiation Rule.* In Order No. 451, the Commission adopted a "good faith negotiation rule" primarily in order to assure that old gas is priced at the lower of the new ceiling price or the market price. While producers must have contractual authority to collect the ceiling price, existing contracts may provide that authority, for example by an indefinite price escalation clause. In order to prevent indefinite price escalation clause from automatically raising prices to the new ceiling price regardless of the market price, the Commission required that parties to existing contracts, who do not voluntarily negotiate a new or amended contract price, comply with the good faith negotiation rule before collecting higher prices. That rule gives both parties an opportunity to assess the value of the gas in light of competition and other market forces. A second purpose of the good faith negotiation rule is to assure fairness in the renegotiation of multi-vintage contracts and give purchasers an op-

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[147a] FERC Stats. & Regs. ¶ 30,665 at 31,564. *See also,* FERC Stats. & Regs. ¶ 30,637 (1985). *See also,* orders setting Tennessee Gas Pipeline Co. (RP86-119-003) 36 FERC ¶ 61,032 (1986), Transwestern Pipeline Co. (RP86-126-000) 36 FERC ¶ 61,048 (1986), Mountain Fuel Resources, Inc. (RP86-87-000) 36 FERC ¶ 61,150 (1986), and ANR Pipeline Co. (RP86-169-000) 37 FERC ¶ 61,080 (1986), for rehearing, where the Commission has set for hearing rate proposals addressing costs related to payments for past and future take-or-pay buyouts.

portunity to reduce substantially their cost of new gas contained in multi-vintage contracts. The rule does this by providing for the renegotiation of new gas in multi-vintage contracts containing some old gas. Finally, the Commission sought to encourage voluntary renegotiation of an alternative to the formal procedures of the good faith negotiation rule.

The good faith negotiation rule operates generally as follows. The rule establishes a three step procedure by which contracts are placed on the bargaining table. In step 1, the producer may request the purchaser to nominate a new price for any old gas sold under contracts or service obligations in effect on July 18, 1986, and which authorize a higher price. In step 2, the purchaser may, within 30 days of the producer's request in step 1, request that the producer nominate a new price for any old gas sold under contracts or service obligations in effect on July 18, 1986, and which authorize a higher price. In step 2, the purchaser may, within 30 days of the producer's request in step 1, request that the producer nominate a new price for any old or other gas sold under the contracts covered by the producer's request. In addition, the purchaser may request the producer to nominate a new price for any gas sold under any other contract between the parties which contains some old gas. In step 3, the producer may, within 30 days of the purchaser's request in step 2, request the purchaser to nominate a new price for any old gas in the contracts brought to the negotiating table by the purchaser in step 2.

Once a nomination request is made by either party, the other party has sixty days in which to nominate a price. The party requesting the nomination then has 30 days in which to decide whether to accept the nominated price. However, if the purchaser nominates the highest price permitted by the contract, the producer must accept the nomination. If a nominated price is accepted, sales continue under the existing contract at the nominated price.

If a party rejects a nominated price, it may, upon 30-days notice, cease sales or purchases from the wells subject to the nomination request, and abandonment is deemed granted. However, a producer may not give the 30-day notice until it has entered into a contract to sell the gas to a new purchaser. In the interim between rejection of a nominated price and abandonment, sales continue at the existing price. Whenever any gas previously sold to a non-Order No. 436 pipeline is eligible for release under the good faith negotiation rule, the producer must give the pipeline's firm sales customers a right of first refusal before selling released jurisdictional gas to a third party.[148]

No contract may be renegotiated more than once under the good faith negotiation rule. Parties may renegotiate a contract at any time without using the good faith negotiation rule. However, voluntary renegotiation after July 18, 1986, prevents any subsequent renegotiation of the contract under the good faith negotiation rule, unless the parties mutually agree in writing to retain their rights under the rule.[149] In order to give the parties time to familiarize themselves with the operation of the rule and to voluntarily renegotiate their contracts, the Commission provided that producers may not proceed under the good faith negotiation rule before November 1, 1986.[150] The Commission has since postponed the start of good faith negotiation to December 18, 1986.

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[148] Issues raised on rehearing concerning the right of first refusal shall be considered in the succeeding section of this order.

[149] The parties' right to mutually agree to retain their rights under the good faith negotiation rule was not in the rule as originally adopted by Order No. 451 but was added by the Interim Order on Rehearing issued July 18, 1986.

[150] A chart illustrating the operation of the good faith negotiation rule, as modified on rehearing, is attached to this order as Appendix C.

Rehearing Requests. Pipelines, distributors, and state utility commissions contends that the good faith negotiation rule is illegal and unfairly weighted in favor of producers. They contend that the provision of the rule permitting producers who have rejected the purchaser's price nomination to abandon sales upon thirty-days notice grants blanket abandonment in violation of section 7(b) of the NGA.[151] That section provides that producers may not terminate sales until the Commission has found, after a hearing, that the present or future public convenience or necessity warrants the abandonment. These parties contend that the Commission improperly held that it could provide the required hearing and make the necessary findings on a generic basis in the present rulemaking proceeding. The applicants contend that, in deciding whether abandonment is in the public interest, the Commission must consider a number of factors which require analysis of facts concerning specific persons and transactions such as the relative needs for the gas of the existing and prospective purchasers and the markets they serve. Allegedly, the Commission can consider such factors only on a case-by-case basis. The applicants also observe that the Supreme Court has held that putting the abandonment decision solely in the hands of the producer would violate section 7(b).[152] The applicants contend the good faith negotiaiton rule does exactly that.

Pipelines, distributors, and consumer representatives also contend that the Commission erroneously held that the good faith negotiation rule does not violate the

[151] Pacific Gas & Electric Co. (PG&E) at 17; Cal PUC at 31; Elizabethtown at 7; Missouri PSC at 5; Northern Natural 13; KN at 26; KP&L *et al.* at 16; ANR and CIG at 4; Southern Natural at 16; Union Gas System, Inc. (Union) at 6; AGD at 9, 11; UDC at 12, 45, 48; Northwest Central at 9, 10, 14; APGA at 46-51; Peoples Gas *et al.* at 10.

[152] United Gas Pipe Line Co. v. McCombs, 442 U.S. 529, 539 (1979).

Mobile-Sierra doctrine.[153] In *United Gas Pipe Line Co. v. Mobile Gas Corp.* 350 U.S. 332 (1956), the Supreme Court held that a natural gas company may not unilaterally change its contract, but that the Commission may modify contracts when necessary in the public interest. These petitioners contend that, since the producer initiates renegotiation and decides whether to accept the nominated price or reject it and abandon sales, the rule allows the producer to abrogate the contract unilaterally. The petitioners also contend that the Commission neither made, nor could make, a finding that permitting contract abrogation is in the public interest. They assert that permitting such abrogation under the good faith negotiation rule undermines the stable supply arrangements which the Supreme Court found in *Mobile* were essential to the health of the natural gas industry.

Pipelines, distributors, and consumer representatives also contend that the good faith negotiation rule is unfairly weighed in favor of producers, thereby preventing the achievement of the Commission's goal of creating more market-responsive pricing and the benefits that flow therefrom. The primary objections are (1) that only producers can initiate the process,[154] and (2) that purchasers cannot obtain the renegotiation of contracts containing only new gas.[155] These features allegedly permit

[153] Missouri PSC at 3; Northern Natural at 22; ANR and CIG at 5; UDC at 50; Northwest Central at 31; APGA at 52.

[154] PG&E at 4; NI-Gas at 17; Panhandle and Trunkline at 16; Transwestern at 9; INGAA at 14; Texas Gas at 7; Natural and United at 9; Texas Eastern at 17; Transco at 7; ANR and CIG at 11; Arkla at 8; Florida Gas at 15; Tennessee at 16; AGD at 15; and AGA at 19.

[155] AGA at 28; AGD at 9; Tennessee at 16; MPC/NASUCA at 33; PG&E at 6; Peoples Gas *et al.* at 25; Cal. PUC at 27; Kentucky PSC at 3; NI-Gas at 15; SoCal at 5; Williston Basin Interstate Pipeline Company (Williston) at 12; El Paso at 4; Northwest Pipeline Corporation at 9; Transwestern at 13; INGAA at 14; Texas

a producer to limit renegotiation to situations where its increased revenues from old gas are likely to outweigh its decreased revenues from new gas, and give the purchaser no recourse. In addition, new gas sold separately from old gas is not subject to the good faith negotiation procedures. As a result, petitioners claim, a large proportion of new gas subject to non-market-responsive contracts will never come down in price. In addition, some old gas sold under multi-vintage contracts will not rise in price and therefore will be prematurely abandoned, contrary to the Commission's goal of maximizing production of old gas.

Beyond the alleged discrimination against pipelines generally, petitioners claim that the good faith negotiation rule also discriminates among pipelines in that pipelines purchasing both old and new gas under separate contracts will experience greater increases in their gas purchase costs than those who generally purchase gas under multi-vintage contracts. These petitioners seek modification of the rule to eliminate the alleged discriminatory features; they also seek numerous other changes, including, for example, clarification of the effect of abandonment on a purchaser's take-or-pay obligations.

Most producers do not question the legality of the good faith negotiation rule. However, some contend that permitting purchasers to seek renegotiation of non-jurisdictional gas in multi-vintage contracts containing some old gas is beyond the Commission's authority.[156] These petitioners contend that section 601 of the NGPA expressly prohibits the Commission from regulating the sale of gas removed from its NGA jurisdiction. Therefore, the Commission allegedly erred in holding that it

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Gas at 7; Missouri PSC at 7; BG&E at 1; Texas Eastern at 8; Transco at 6; ANR and CIG at 8; Florida Gas at 18; Arkla at 10; D.C. PSC at 4; Northwest Central at 51.

[156] Atlantic Richfield *et al.* at 3, 7.

could subject non-jurisdictional gas to renegotiation as a condition of a producer's eligibility for a higher ceiling price for jurisdictional old gas. Other producers, while not contesting the Commission's authority to include non-jurisdictional gas in the good faith negotiation rule, contend that such inclusion is unwise as a matter of policy.[157] They argue that Order No. 451 amply demonstrates that competition will bring down the price of new gas in any event, and that the inclusion of new gas serves only to render the good faith negotiation rule overly complex and thus discourages negotiations under the rule.

Producers contend that the good faith negotiation rule is unfairly weighed against them in a number of other respects which will be addressed in the succeeding discussion. Producers, like pipelines, distributors, and consumer representatives, request numerous clarifications and minor alterations in the rule.

Commission Response. The Commission will first consider the rehearing applicants' major challenges to the legality of the good faith negotiation rule. It will then address the applicants' various other requests for clarification or modification of the rule.

1. *Legality of the Good Faith Negotiation Rule.*

a. *Abandonment under the Good Faith Negotiation Rule Does Not Violate NGA Section 7(b).*

The Commission firmly believes that Order No. 451's grant of abandonment if the purchaser fails to nominate an acceptable price comports with the requirements of NGA section 7(b). The Commission properly found in Order No. 451, after due hearing, that the present and future public convenience or necessity permit abandonment when the conditions set forth in the good faith ne-

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[157] Indicated Producers at 4.

gotiation rule are met. The ultimate criterion in determining whether abandonment should be granted under section 7(b) is the public interest.[158] As the Commission stated in Order No. 451, abandonment under the good faith negotiation rule is in the public interest, since it is necessary to ensure that the goals of Order No. 451 of increased production of old gas and overall lower prices described in sections IV. D. and E. *supra* are achieved. Those goals cannot be achieved unless producers can obtain the market-responsive prices permitted by the rule. Without the possibility of abandonment, purchasers under existing contracts could prevent producers from obtaining those prices by insisting on continuation of the present price. In addition, requiring individual producers to file abandonment applications and considering those applications on a case-by-case basis is an inadequate solution. That would cause lengthy delays before abandonments could be granted, given the vast number of producers in the nation and the Commission's limited resources. Achievement of the goals of increased production and lower overall prices would thereby be substantially delayed. Thus, granting abandonment in the present proceeding, if the conditions set forth in the good faith negotiation rule are met, is in the interest of the natural gas market as a whole and is necessary to bring about market-responsive prices for old gas and overall lower prices.

It is true, as a number of petitioners note, that before granting abandonment the Commission must consider all factors relevant to the public interest and that historically, under standards developed in cases such as *Michigan Consolidated Gas Co. v. FPC*[159] and *Transco, supra*, these factors have included (1) a comparison of the needs

[158] Transcontinental Gas Pipe Line Corp. v. FPC (*Transco*), 488 F.2d 1325, 1328 (D.C. Cir. 1973), *cert. denied*, 417 U.S. 921 (1974).

[159] 283 F.2d 204 (1960), *cert. denied*, 364 U.S. 913 (1960).

of the existing purchaser and the prospective purchaser of the gas and of the markets which each serve, (2) a presumption in favor of continued service and the relative diligence of the respective pipelines in providing for adequate supplies, (3) the contractual arrangements between the parties, and (4) the environmental impact of the abandonment decision. However, in the recent case of *Felmont Oil Corporation and Essex Offshore, Inc.*,[160] the Commission rejected the notion that the public interest cannot evolve as conditions change or that the Commission cannot revisit and revise the abandonment policy of the *Transco* and *Michigan Consolidated* cases in light of changed industry conditions, regulatory context and valid policy objectives. The Commission stated that enactment of the NGPA has virtually eliminated the concerns which formed the basis of the Commission's traditional abandonment policy. Instead, experience under the NGPA demonstrates that reliance on market forces to allocate supplies of gas works to the benefit of the public by preventing shortages. Thus, in *Felmont*, the Commission held that these facts permit the Commission, when considering abandonment applications, to shift its focus, from the interests of specific customers and their access to particular sources of supply, to the interests of the market as a whole. Pursuant to this shift in the identification of the public interest, the Commission in *Felmont* permitted abandonment of certain low-cost old gas supplies which the pipeline had shut in in order to take higher-cost new gas subject to take-or-pay obligations. The Commission stated that such abandonment served the interest of the market as a whole since it would permit the low-cost gas to enter the market place, displace higher-cost gas, and help to reduce the overall cost of gas. So also, by the abandonment granted here through the good faith negotiation rule, the Commission seeks to

[160] Opinion No. 245, Docket No. CI84-10-000, 33 FERC ¶ 61,333 (1985); appeal docketed *sub nom.* Consolidated Edison of N.Y. v. FERC (D.C. No. 86-1168).

permit old gas to enter the marketplace, placing downward pressure on overall prices.

Of course, as petitioners for rehearing point out, the Commission in *Felmont* stated that it would continue to weigh the factors which it previously considered, including the parties' comparative needs, their contract arrangements, and the environmental and economic consequences of the abandonment. And the petitioners observe that the Commission did carefully consider those factors in *Felmont*, considering evidence concerning the specific parties there involved. The petitioners contend that the Commission has not, and cannot, consider those factors in the present rulemaking proceeding, since such consideration requires case-by-case analysis.

In this proceeding, the Commission could and did consider all relevant factors involved in determining the overall public interest. The Commission believes that generally a purchaser's loss of gas under abandonment provisions of the good faith negotiation rule should not cause it, or the market it serves, to experience a shortage of supply. The move to market-responsive prices for new gas over the last eight years under the NGPA has already eliminated shortages of gas. Allowing old gas prices also to rise to market-responsive levels up to replacement cost will ensure that present adequate supplies of gas continue into the foreseeable future.[161] Therefore, there is no reason to believe that purchasers losing supplies under this rule should have difficulty replacing those supplies. In addition, the lower overall prices brought about by this rule should allow the purchaser to replace lost supplies at reasonable prices.[162] Furthermore, this

[161] *See* the discussion in Part IV. D. above.

[162] In short, the Commission relies on market forces to assure that purchasers have adequate supplies at reasonable cost. Such reliance on market forces in the context of NGA section 7(b) is supported by the Supreme Court's decision in *FCC v. WNCN Listeners Guild*, 450 U.S. 582 (1981). That case involved a similar

rule protects the interests of the firm sales customers of non-Order No. 436 pipelines by granting them a right of first refusal. Of course, initially at least, some persons, particularly those who benefited from the distortions inherent in the old vintage-based calling price structure, may experience price increases. However, such isolated instances are outweighed by the benefits to the market as a whole described above. Since abandonment occurs under the good faith negotiation rule only if the purchaser has chosen not to pay the price provided for under the contract, in effect terminating the contract, there is nothing in the parties' contractual arrangements militating against abandonment. The presumption in favor of continued service under these circumstances is outweighed by the need to obtain the overall benefits for the public described above.[163] As the Commission discusses in sec-

requirement that the FCC determine whether the "public interest, convenience, and necessity" permit radio station license renewals or transfers. Among the factors to be considered in making the necessary determination is whether granting the renewal or transfer will promote diversity in entertainment programming. The FCC issued a policy statement that it would not consider this factor in individual cases since it could rely on market forces to promnte diversity. The Supreme Court upheld the policy statement, holding that the FCC had provided a rational explanation of its reliance on the market. In the present order and in Order No. 451, the Commission has provided a detailed explanation why under this rule market forces should assure adequate supplies at reasonable costs. *See* Order No. 451, 51 Fed. Reg. at 22,194-22,204. *See* sections IV. E. and G. of this order.

[163] The relative diligence of purchasers in providing for adequate natural gas supplies has less relevance in determining the public interest in a time of surplus rather than shortage. That factor is primarily of use in determining relative equities when allocating shortages among two pipelines that both lack adequate supplies. When all purchasers have adequate supplies, it is difficult to find that any have lacked diligence in obtaining such supplies. The effect of this rule is to provide an adequate economic incentive to ensure production of available lower-cost reserves that otherwise probably would not be available to those purchasers.

tion V. C. of this order, the Commission does not believe that this rule will have any significant adverse environmental consequences. The Commission concludes that it properly found in Order No. 451 that granting abandonments under the good faith negotiation rule is required by the public interest. Since the public interest is "the ultimate criterion under section 7(b)," [164] the standards for granting abandonment under section 7(b) have been met.[165]

The Commission also rejects rehearing applicants' contention that granting abandonment under the good faith negotiation rule is contrary to *United Gas Pipe Line Co. v. McCombs*, 442 U.S. 529 (1979). In that case, the Supreme Court reversed a lower court holding that, upon depletion of reserves, a producer may abandon sales without obtaining any prior Commission approval. The Court reasoned that permitting abandonment without prior Commission approval would leave the abandonment de-

[164] *Transco*, 488 F.2d at 1328.

[165] Some applicants also rely on various statements in Order No. 436-A (50 Fed. Reg. at 52,259) concerning the expedited abandonment policy established in Order No. 436 (*see* 18 C.F.R. § 2.77) to contend that the Commission must consider abandonments on a case-by-case basis. It is true that in Order No. 436-A the Commission emphasized that abandonment applications based on the Commission's policy statement at § 2.77 would be granted only on a case-by-case basis. However, nothing in that order was intended as a statement that the Commission could not in appropriate circumstances grant abandonment in a rulemaking proceeding such as the present. For the reasons stated above, the Commission believes that it is appropriate to grant abandonment in the final rule when the conditions set forth in the good faith negotiation rule are met. Furthermore, the Commission observes that, at the request of certain pipelines, it has granted limited-term abandonment authority to numerous suppliers of the pipeline rather than as in *Felmont*, considering only the abandonment of a specific contract between one producer and the pipeline. *See, e.g.*, Southern Natural Gas Co., 36 FERC ¶ 61,401 (1986) and Transcontinental Gas Pipe Line Corp., 36 FERC ¶ 61,403 (1986).

termination "as a practical matter, in the producer's control, a result clearly at odds with Congress' purpose to regulate the supply and price of natural gas." [166] The present case is distinguishable from *McCombs* since no abandonment without prior Commission approval is here involved. The Commission has in Order No. 451 granted prior approval of abandonments under the good faith negotiation rule as being in the public interest.

One applicant [167] asserts that section 1(a) of the Interstate Commerce Act (ICA) has been interpreted as requiring the Interstate Commerce Commission (ICC) to consider requests for abandonment of service by railroads on a case-by-case basis. The applicant notes that section 1(a) of the ICA is virtually identical to section 7(b) of the NGA, requiring a finding that the "present or future public convenience and necessity" permits abandonment of service. Accordingly, the applicant argues that section 7(b) should also be interpreted as requiring case-by-case consideration of abandonment requests.

The Commission's review of precedent concerning the ICC's authority under section 1(a) and other relevant provisions of the ICA indicates that, far from supporting the proposition that section 7(b) of the NGA requires case-by-case determinations, that precedent supports the Commission's grant of abandonment in Order No. 451. Both sections 14 and 210 [168] of the ICA, requiring that the ICC find that grants of a license to engage in particular activities are in the "public interest," have been interpreted as permitting the ICC to make generic findings applicable to all license applications that the public

[166] 442 U.S. at 539.

[167] Northwest Central at 13-14.

[168] 49 U.S.C. §§ 10924 and 10930. (Former sections 14 and 210 have recently been revised and recodified as §§ 10924 and 10930).

interest standard is met.[169] This is so even though the ICC previously granted such licenses on a case-by-case basis. Since the ultimate criterion under section 7(b) of the NGA is also the public interest, these cases support the Commission's action here. Of the two cases cited by the applicant, one[170] merely states generally that the ICC must balance the interests of presently served customers with those of the carrier and the transportation system. It does not state that the balancing must be done on a case-by-case basis. The other[171] does contain dicta that certain legislative history relied on by the appellant for one point does not address that point, but indicates "that 'public convenience and necessity' must be determined in each case on the basis of the factors that are presented in that instance. *See* H.R. Rep. No. 456, 66th Cong. 1st Sess. 146-52 (1919)." The Commission's review of the document cited reveals no indication that findings of public convenience and necessity must be made on a case-by-case basis. Rather, the essential issue raised in the course of legislative consideration of the section appears to have been whether the states or the Federal government should have jurisdiction to make the determinations.

Finally, the Commission has provided the hearing required by section 7(b) in the present proceeding. The Commission has provided all segments of the natural gas industry an opportunity to file initial and reply comments. Two days of public hearings were held. All interested persons have had the opportunity to present further arguments on rehearing. The only argument as to why this opportunity for hearing is inadequate is that

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[169] American Trucking Associations, Inc. v. United States, 602 F.2d 444 (D.C. Cir. 1979). National Tour Brokers Ass'n v. ICC, 671 F.2d 528 (D.C. Cir. 1982).

[170] Chicago and North Western Transportation Co. v. Kalo Brick & Tile Co., 450 U.S. 311, 321 (1981).

[171] Farmland Industries Inc. v. U.S., 642 F.2d 208, 211 n.5 (7th Cir. 1981).

the Commission allegedly cannot consider all relevant factors, including the effects of individual abandonments on affected parties, other than on a case-by-case basis. That argument has been answered above.[172]

b. *The Good Faith Negotiation Rule Does Not Violate the Mobile-Sierra Doctrine.*

The Commission also rejects contentions by various rehearing petitioners from all segments of the natural gas industry that the good faith negotiation rule violates the *Mobile-Sierra* doctrine. Pennzoil Company and Pennzoil Producing Company contend that the good faith negotiation rule unlawfully abrogates indefinite price escalation clauses in existing contracts. Those clauses allegedly authorize collection of the just and reasonable rate established by this rule. Yet the good faith negotiation rule does not permit a producer to collect that price until it has given the purchaser an opportunity to renegotiate the contract in question and certain other contracts. Pennzoil argues that, since the Commission has found the new ceiling price to be just and reasonable, the Com-

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[172] Some applicants claim that in Order No. 451 the Commission improperly relied on Phillips Petroleum Co. v. FPC, 475 F.2d 842, 848-52 (10th Cir. 1973) and American Public Gas Ass'n v. FPC, 567 F.2d 1016, 1064-67 (D.C. Cir. 1977), in holding that the hearing provided in the present proceeding satisfies the section 7(b) hearing requirement. The Commission disagrees. While those cases involved the issue whether the Commission may entablish area and national rates in rulemaking proceedings without violating the hearing requirements of NGA sections 4 and 5, those sections require similar findings concerning the public interest as does section 7(b). Applicants also attack the Commission's reliance on Texaco v. FPC, 377 U.S. 33, 44 (1964), and FPC v. Moss, 424 U.S. 494, 500-01 (1976). The Commission recognizes that those cases are not precisely on point. Nevertheless, *Texaco* supports the proposition that the Commission has discretion to establish expeditious administrative methods in order to achieve its regulatory purposes and *Moss* supports the proposition that the Commission may pregrant abandonment even though years may elapse before the abandonment actually occurs.

mission cannot make the requisite finding that abrogation of the indefinite price escalation clause is in the public interest.

The Commission first observes that it has not found that automatic collection of the new ceiling price is necessarily appropriate, even though the new ceiling price is within the zone of reasonableness for replacement costs, and therefore just and reasonable. The Commission recognizes that the new ceiling price may be above prevailing market prices. Accordingly, the Commission adopted the good faith negotiation rule, as an integral part of obtaining the new ceiling price, in order to assure that producers do not collect above-market prices for gas under existing contracts with indefinite price escalation clauses. Without that rule the price of the 90 percent of old gas sold under such contracts would automatically escalate to the ceiling price regardless of the market price. This would not be a just and reasonable result in the sense of providing for the lowest reasonable rate under MGA section 5(a). Thus, the requirement that producers comply with the good faith negotiation rule clearly is in the public interest, and provides for a transitional gradation toward the ultimate just and reasonable ceiling available under the rule.

Furthermore, the Commission believes that that rule does not abrogate indefinite price escalation clauses for the same reasons the court in *Pennzoil Co. v. FERC* (*Pennzoil II*)[173] held that the Commission's requirement of specific contractual authority for collection of the section 107(c)(5) ceiling price also does not abrogate indefinite price escalation clauses in violation of the *Mobile-Sierra* doctrine. As the Commission made clear in Order No. 451, indefinite price escalation clauses may provide the necessary *contractual* authority to collect the alternative ceiling price; however, in order to assure that the

[173] 671 F.2d 119, 124-25 and nn.13 and 14 (5th Cir. 1982).

rate actually *collected* is just and reasonable, the Commission requires compliance with the good faith negotiation rule unless the parties voluntarily renegotiate. In other words, while the indefinite price escalation clause continues to provide contractual authority to collect the highest just and reasonable price allowed by law, the alternative ceiling price is allowed by law only if parties specifically agree to it under the good faith negotiation rule or otherwise. Since the ceiling price adopted under sections 104 and 106 is just and reasonable and since the purpose of the good faith negotiation rule is to assure that the price collected thereunder is the lowest just and reasonable price within that ceiling, the rule clearly furthers the Commission's legitimate regulatory policies.[174]

Pipelines, distributors, and consumer representatives also claim that the good faith negotiation rule violates the *Mobile-Sierra* doctrine, although for different reasons. They claim the rule permits producers to terminate contracts unilaterally and that the Commission cannot make the necessary finding that such termination is in the public interest since it adversely affects pre-existing supply arrangements. The Commission fully discussed this issue in Order No. 451. While permitting producers

[174] This discussion should alleviate the concern of one applicant (El Paso at 16-18) that, because the Commission allegedly has found the new ceiling price to be just and reasonable, an indefinite price escalation clause might be interpreted as agreement to pay the new ceiling price. Under this interpretation, a purchaser's failure to nominate the new ceiling price would constitute a breach of the indefinite price escalation clause. As stated above, the Commission has not found automatic collection of the new ceiling price necessarily just and reasonable. It is only just and reasonable to the extent agreed to under the good faith negotiation rule or as a result of voluntary renegotiation. Thus, no purchaser is in any way obligated to pay the new just and reasonable ceiling price. Rather, the producer, as a condition of eligibility for making a transition toward the higher rate, is required to give the purchaser an opportunity to negotiate for a lower price.

and purchasers to terminate their contracts, the good faith negotiation rule requires that as a condition for seeking the alternative ceiling price otherwise provided for by the contract's indefinite price escalation clause, producers must give the purchaser an opportunity to seek a lower price under that contract and certain other contracts. Any termination of the contract results from the purchaser's decision to offer a price lower than that provided by the contract. Since any contract termination occurs only through the parties' mutual exercise of their rights under the good faith negotiation rule, there is no unilateral contract termination in violation of the *Mobile-Sierra* doctrine. Nor is there any need for the Commission to make a finding that permitting unilateral abrogation of the contracts is in the public interest, since none is permitted. In any event, in the discussion above finding that abandonment under the good faith negotiation rule is permitted by the public convenience or necessity, the Commission has shown that any mutual contract termination and abandonment which occurs under the good faith negotiation rule is in the public interest in spite of its effect on the parties' past supply arrangements.

c. *The Commission Has Authority to Permit Purchasers to Seek Lower Prices for Non-Jurisdictional Gas under the Good Faith Negotiation Rule.*

Several producers [175] contend that the Commission exceeded its authority by permitting purchasers, in step 2, to seek a lower price for any new gas, including non-jurisdictional gas, in any contract between the parties which includes old gas. These applicants point out that NGPA section 601 removes certain new gas from the Commission's NGA jurisdiction. They assert that conditioning a producer's right to obtain the new just and reasonable rate for old gas on renegotiating non-

[175] Atlantic Richfield *et al.*

jurisdictional gas amounts to backdoor regulation of that gas in violation of NGPA section 601. They find support for this view in *Pennzoil Co. v. FERC (Pennzoil I)* 645 F.2d 360 (5th Cir. 1981), holding that the Commission lacks authority to regulate non-jurisdictional gas sales in the guise of contract interpretation.

The Commission has not exceeded its authority. It does not seek to reregulate sales of non-jurisdictional gas through the good faith negotiation rule. Rather, as described above, it seeks to establish a condition of eligibility to ensure that the price collected for old jurisdictional gas is just and reasonable. As described in Order No. 4517, purchasers may have agreed to a higher price for new gas, including non-jurisdictional gas, in a multi-vintage contract in reliance on the fact that the lower cost of the old gas reduced the average price under the contract. The Commission believes that in such circumstances it would be unjust and unreasonable for the producer to collect, pursuant to the new price ceiling, a higher price for the old gas, whether from the existing purchaser or from a new purchaser after abandonment, without giving the existing purchaser under the contract an opportunity to renegotiate the price of the new gas. The Commission also believes it would be unjust and unreasonable to permit a producer to renegotiate only those multi-vintage contracts where it will gain a net increase in price because the contracts contain primarily old gas. The provision of the good faith negotiation rule permitting purchasers to seek a lower price in step 2 for any gas in contracts containing some old gas follows from this reasoning. Accordingly, the Commission believes that, pursuant to its authority recognized in *Pennzoil II* to define criteria for eligibility for a ceiling price in order to further its legitimate regulatory policies, it may include this provision in the good faith negotiation rule.[176]

[176] *See also* Texas Eastern Transmission Corp. v. FERC, 769 F.2d 1053 (5th Cir. 1985).

The producers seek to distinguish *Pennzoil II* primarily on two grounds. First, they contend that the rationale of that case applies only to "special rates," such as the NGPA section 107(c)(5) ceiling price, which Congress authorized the Commission to establish "to the extent necessary" to achieve a stated goal. Eligibility criteria allegedly are permissible as a means of limiting the special rate to that gas which requires the special rate to achieve the stated goal. Producers claim that rates established under sections 104 and 106 are not such special rates. However, the Commission sees no significant distinction between the rate involved in *Pennzoil II* and that involved here. The Commission may establish higher ceiling prices under section 104 and 106 only to the extent such prices are just and reasonable under the NGA. As described above, that is the purpose of this condition in the good faith negotiation rule.

Second, producers contend that the Commission cannot find, as required by *Pennzoil II*, that the condition here involved is reasonably calculated to further its legitimate regulatory policies. The producers claim that the regulatory policy here involved is the prevention of premature abandonment of low-cost old gas, that requiring producers to submit non-jurisdictional gas to renegotiation does not serve this purpose, and that to do so is contrary to the stated goal, since some producers may thereby be discouraged from seeking the price increases for old gas necessary to keep that gas in production. Producers also state that, since the Commission expects new gas prices to be renegotiated downward in any event, there is no need to require producers to submit new gas sold under multi-vintage contracts to renegotiation in step 2.

The Commission believes that the condition here involved is reasonably calculated to further its regulatory policies. When the Commission establishes a just and reasonable rate, it must balance a number of factors, some of which conflict with one another. In the present

case, the Commission must balance the need for higher prices for old gas to avoid premature abandonment with fairness to purchasers. The Commission recognizes that conditioning higher prices for old gas on renegotiation of the price of any other gas may discourage some producers from seeking higher prices and thus reduce to some extent the increased production sought in this rule. On the other hand, purchasers may have relied on low prices for old gas in agreeing to pay higher prices for new gas, whether that new gas is in multi-vintage contracts or not. Thus, failure to condition higher prices for old gas on renegotiation of other gas prices may involve unfairness to purchasers. The Commission has balanced these two concerns by conditioning higher prices for old gas on renegotiation only of the price of new gas sold under multi-vintage contracts between the producer and purchaser including some old gas. Requiring the renegotiation of all new gas prices, including that sold under separate contracts, could make the rule so costly to producers that few would seek higher old gas prices, thereby preventing achievement of the rule's goal of increased old gas production. Also, the relationship between old and new gas prices is less clear when the two are sold under separate contracts. However, as discussed above, where the two are sold under the same contract, the contractual relationship is so intertwined that it would be unfair to allow renegotiation of one of the strands of consideration to permit higher old gas prices with no provision for renegotiation of other threads of the contractual balance related to new gas prices.

It is true that the Commission expects new gas prices to be renegotiated downward as a result of the market forces released under this rule. However, there could, over the short term, be a lag between a producer obtaining a higher price for old gas under the good faith negotiation rule and market forces having their full effect on the new gas price. The purchaser's rights in step 2 assure that lag does not occur with respect to new gas sold

in multi-vintage contracts. The fact that market forces will bring down new gas prices does, however, reduce the Commission's concern about the fairness of excluding from step 2 of the good faith negotiation rule new gas sold separately. Finally, since about two thirds of new gas is sold under separate contracts,[177] limiting the new gas the producers must submit to renegotiation to new gas sold with old gas means that the costs of seeking higher prices for old gas should not be so high as to discourage producers from seeking higher prices for a sufficient amount of old gas to permit significant increased production. The Commission concludes that permitting purchasers to seek renegotiation of the price of all new gas, including non-jurisdictional gas sold in contracts with old gas, furthers the Commission's legitimate regulatory policies and is permitted by the authority to establish eligibility requirements for NGPA prices confirmed in Pennzoil II. The Commission has not reregulated new gas. Rather, it has simply sought to assure that the price obtained for jurisdictional sections 104 and 106 gas is just and reasonable.

d. *The Good Faith Negotiation Rule Is Not Unfairly Weighted in Favor of Producers.*

The Commission now turns to contentions of many pipelines, distributors, and consumer representatives that the good faith negotiation rule is unfairly weighted in favor of producers, since only producers can initiate the process and purchasers cannot obtain renegotiation of new gas not sold in multi-vintage contracts with old gas. These provisions of the rule allegedly have three major discriminatory effects preventing achievement of the Commission's goal of market-responsive pricing for all gas. First, they allow most high-cost, non-market-responsive new gas to escape downward renegotiation under the good faith negotiation rule. As previously

[177] AGA at 4.

noted, approximately two thirds of new gas is sold in separate contracts containing no old gas which cannot be renegotiated under the good faith negotiation rule.[178] Also, not all of the remaining high-cost gas will be renegotiated under the good faith negotiation rule. The fact that only producers can initiate good faith negotiation allows producers to limit renegotiation under the rule to situations where the potential for increased revenues from higher old-gas prices outweighs the risk of decreased revenues from lower prices for new gas sold with old gas. The failure of the good faith negotiation rule to reach non-market-responsive, new-gas contracts allegedly means that overall gas prices will increase as a result of higher old-gas prices, since applicants believe that the Commission's contention that competition will lower the price of high-cost gas apart from the good faith negotiation rule is unsupported by substantial evidence.

The second discriminatory effect alleged by applicants is that some purchasers will be more adversely affected than others. Some purchasers buy a higher percentage of their new gas under multi-vintage contracts than do others. Those purchasing more of their new gas under separate contracts will have less ability to renegotiate downward the price of that gas than those purchasing

[178] A number of applicants claim that the exclusion of new gas sold under separate contracts from the good faith negotiation process is particularly arbitrary in light of two additional factors. First, the rationale for inclusion of new gas in multi-vintage contracts allegedly applies equally when old and new gas is sold to a purchaser under separate contracts. In both cases, the purchaser relied on its ability to roll in the low-cost old gas with high-cost new gas in agreeing to pay higher prices for the old gas. Second, the decision whether to include old and new gas in on contract or separate contracts was largely an arbitrary drafting decision. Indeed, the Commission allegedly encouraged separate contracts under § 272.102(c) of its regulations as in effect before 1980 (AGA at 30-31).

more of their new gas under contracts containing old gas. Similarly, producers selling most of their new and old gas under separate contracts will obtain a higher net price increase than those selling more gas in multi-vintage contracts.

Finallv, applicants contend that, to the extent producers refrain from seeking higher prices for their old gas under the good faith negotiation rule in order to avoid renegotiation of the price of new gas sold under multi-vintage contracts, the beneficial effects claimed by the Commission from higher old-gas prices will not occur. The old gas will be prematurely abandoned. This will impede achievement of the Commission's goal of lowering overall prices.

Applicants contend that for these reasons the good faith negotiation rule is arbitrary and capricious, grants undue preference to particular producers and pipelines and provides for unjust and unreasonable rates in violation of NGA section 5. Applicants propose two main changes in the rule to avoid these problems and provide market-responsive pricing for all gas. First, they propose that purchasers be permitted to initiate good faith negotiations, at least with respect to any contract containing any old gas. Applicants contend that, having found the present vintage-based pricing system unjust and unreasonable, the Commission has the legal authority under NGA section 5 to allow purchasers to initiate good faith negotiations as the necessary remedy to eliminate the present unjust and unreasonable rates. Second, they propose that, once the producer seeks a higher price for any old gas, the purchaser should be able to seek lower prices for new gas covered by any contract between the parties, regardless of whether that contract contains old gas. The applicants argue that, if the Commission has legal authority to condition eligibility for higher old gas prices on renegotiating all gas in multi-vintage contracts, that same authority permits it to condition higher old-

gas prices on renegotiation of gas in all contracts with the purchaser. Another proposal is to allow any purchaser from a particular producer to exercise its rights under step 2 of the good faith negotiation rule once that producer has requested one of its purchasers to nominate a price in step 1.[179]

Tennessee[180] proposes a more radical solution of replacing the entire good faith negotiation rule with a requirement that bilateral market-out clauses be included in all contracts. Process Gas Consumers Group (PGC)[181] proposes that the Commission require that a producer be required to file an affidavit agreeing to renegotiate fully all its contracts with any interstate pipeline that accepts Order No. 436 before seeking a higher price under any contract. PGC contends this would give pipelines a greater incentive to accept Order No. 436 and also make a producer more willing to risk potential renegotiation of all its higher priced supplies since the pipeline's acceptance of Order No. 436 would give the producer needed non-discriminatory access to wider markets for all its gas, not just released supplies.

The Commission does not believe that the good faith negotiation rule as adopted is discriminatory or that it must be altered to permit purchasers to initiate the process and to renegotiate all new gas prices. Applicants' contentions proceed from a false predicate; they assume that non-market-responsive, high-cost new gas prices will not come down unless purchasers are given a means to bring them down under the good faith negotiation rule. This is not true. As explained in detail in Section IV. E. of Order No. 451,[182] the Commission believes that competitive

[179] AGA at 27; PG&E at 5; NI-Gas at 17; Williston at 12.

[180] at 4-9.

[181] at 12-14.

[182] 51 Fed. Reg. at 22,194-22,197.

forces in the natural gas market, including competition from alternative fuels, increased production of old gas, and more accurate price signals, will force down the price of non-market-responsive gas, wholly apart from the good faith negotiation rule. Therefore, it is unnecessary to modify the rule in any of the ways suggested in order for the increased production of old gas encouraged by this rule to bring overall prices down. The two-thirds of new gas which cannot be renegotiated under the good faith negotiation rule will nevertheless respond to competitive forces in the natural gas market which will be strengthened by increased production resulting from this rule. The record amply demonstrates that higher gas prices have, in fact, fallen as a result of competitive forces.[183] Also, producers not immediately initiating good faith negotiation, because they believe any increased revenues from old gas will be more than offset by lost revenues from new gas sold with old gas, will find the price of their high-cost gas nevertheless coming under heavy competitive pressure as other producers take advantage of the rule. Purchasers may reduce takes of the high-cost gas. Thus, it may well become worthwhile for them to seek the higher prices permitted by the market for their old gas in order to offset the inevitable decline in the price of their high-price gas.

The fact that high-cost gas will respond to competitive market forces even though not subject to renegotiation under the good faith negotiation rule should also prevent the various other discriminatory effects alleged by applicants. Because prices of all new gas will come down, purchasers buying their new and old gas under separate contracts should not experience higher gas costs over the long term any more than those purchasing such gas under

[183] See also "First to Pay, Last to Gain," a report by the Citizen/Labor Energy Coalition issued October 1986, showing that from the first half of 1984 to the first half of 1986 the wellhead price of gas dropped 65 cents per Mcf or 24 percent.

multi-vintage contracts. Producers selling most new and old gas under separate contracts should not obtain higher prices than those selling primarily under multi-vintage contracts. Also, since most producers are likely to seek eventually over an extended period of time higher prices for old gas, little old gas will remain at present low regulated prices and thus be prematurely abandoned, contrary to some applicants' contentions.

For these reasons alone there is no need to amend the good faith negotiation rule to avoid discrimination. In addition, there are other grounds for rejecting the proposed amendments to the good faith negotiaion rule. First, the Commission doubts its authority to permit purchasers to initiate the process, since that might result in purchasers' unilaterally terminating high-cost contracts in violation of the *Mobile-Sierra* doctrine as embodied in NGPA section 101(b)(9).[184] Under the good faith negotiation rule as adopted, if the producer does not want to risk the pipeline terminating purchases of high-cost gas, it need not invoke the good faith negotiation procedures. The purchaser too has an opportunity to prevent the contract from terminating, by paying the contract price or voluntarily renegotiating. Thus, termination of purchases results only from mutual decisions by the producer and purchaser. The situation would be very different if the purchaser could invoke the good faith negotiation procedures; then the purchaser's right to terminate would arise not because the producer chose to grant the purchaser such a right as a condition of obtaining the benefit it sought. Rather, the purchaser's right to terminate would arise from its unilateral action in initiating good faith negotiation.

Nor is the Commission convinced by the applicants' contention that it has authority to grant purchasers the right to initiate good faith negotiation under section 5 of the

[184] *See* Pennzoil Co. v. FERC, 671 F.2d 119, 125 (5th Cir. 1982).

NGA. Applicants contend that that authority arises because the Commission has found in Order No. 451 that the present pricing structure is unjust and unreasonable. However, the Commission only found that the present rigid, vintage-based old gas price structure is unjust and unreasonable. The Commission has not found that gas prices for new gas are unjust and unreasonable. In fact, the current much lower prices for large amounts of new gas renegotiated or subject to market outs could not be found unjust or unreasonable. In any event, the Commission lacks authority to find new gas prices unjust and unreasonable. Some new gas prices are set pursuant to NGPA price ceilings and the remainder are set in the open market pursuant to deregulation. All such rates are deemed to be just and reasonable under section 601(b) of the NGPA. However, based on the Commission's finding that the old gas prices had become unjust and unreasonable, the Commission reformed the old gas pricing structure to set new just and reasonable ceiling prices pursuant to NGPA sections 104 and 106. Accordingly, it provided for renegotiation of new gas prices only where the old and new gas volumes were so inextricably intertwined, because covered by the same contract, that such renegotiation may be conceived of as part of the adjustment of the old gas price under the contract. All terms of such a multi-vintage contract are so-interrelated that it would not be equitable to adjust the old gas prices under the contract without allowing the new gas price aspects of the contract to be open to adjustment in turn.

While rehearing applicants have argued for the Commission's authority to permit purchasers to seek renegotiation of all new gas prices, including that not sold with old gas, after producers have initiated the process, the Commission believes there are strong policy reasons not to do so, apart from the fact competition will force down new-gas prices in any event. If a producer's request for the purchaser to nominate a new price for old gas in step 1 instantly gave the purchaser the right to renegotiate all other contracts with the producer including those not containing old gas, the potential cost to a producer of initiating good faith negotiation would in many instances undoubtedly be greater, perhaps far greater, than under the current procedure so that fewer producers would initiate the process. This would seriously impede achievement of the Commission's goal of market responsive prices for old gas so as to avoid premature abandonment of that gas. Without higher prices for old gas and the resulting increased production of old gas, the competitive pressures forcing down high-cost prices would be lessened.

The Commission rejects the contention that it arbitrarily distinguished new gas sold in multi-vintage contracts containing some old gas from new gas sold separately. It is, of course, true that purchasers may have relied on their ability to roll in high-cost new gas with low-cost old gas in agreeing to pay a higher price for the new gas, regardless of whether the new gas was purchased in a multi-vintage contract with old gas or separately. In striking the balance previously described between the need for higher prices for old gas and fairness to purchasers, the Commission determined that fairness to purchasers required giving them a right to renegotiate under the good faith negotiation rule all new gas sold under the same contract with old gas. This assures that there is no significant lag between the producer's obtaining a higher price for old gas sold under such contracts and the purchaser's obtaining a lower price for the new gas. Again, all terms of multi-vintage contract relations are interrelated and it would not be fair to disrupt the mutuality of consideration between the parties. Accordingly, the rule applies to such contracts. However, in order not to render negotiations under the good faith negotiation rule so costly to producers so that in the short run few would initiate such negotiations, the Commission believes it appropriate to exclude new gas sold under separate contracts from negotiations under the good faith negotiation rule. While this may result in some lag between the producer's obtaining a higher price for the old

gas and the purchaser's obtaining a lower price for the new gas, the market forces released by this rule, including more accurate price signals and increased production of old gas, should bring down the price of the new gas sold under separate contracts. Therefore, the Commission concludes that exclusion of that gas from the good faith negotiation process is not unfair to purchasers.

The Commission also rejects the separate proposals of Tennessee and PGC. The Commission believes these proposals to be unnecessary since, as stated above, new-gas prices are expected to come down in any event. In addition, since as explained above, the Commission has not found new-gas prices to be unjust and unreasonable, the Commission doubts its authority to require market-out clauses to be included in all contracts. In any event, while the Commission recognizes the value of market-out clauses in encouraging market-responsive pricing, such clauses should be adopted through negotiation between the parties, not Commission fiat. The Commission is handicapped in analyzing PGC's proposal by the fact that the details of that proposal are unclear. For example, PGC does not state what rights Order No. 436 pipelines would have if they failed to reach agreement with the producer on a lower price for new gas. If the existing contract price would continue in effect, the proposal appears to grant pipelines no additional rights over what they now have. Presumably, however, PGC intends the pipeline to have rights similar to those granted under the good faith negotiation rule. Granting Order No. 436 pipelines greater bargaining rights than non-Order No. 436 pipelines and other purchasesrs who are not pipelines at all appears unfair and possibly in violation of the prohibition against undue preference. Furthermore, allowing all Order No. 436 pipelines the right to demand lower prices for new gas or terminate purchases if the producer seeks a higher price for any old gas with any purchaser appears to suffer from the infirmity that it would discourage producers from seeking higher prices

for old gas, thus impeding achievement of the goals of this rulemaking.

For all of the above reasons, the Commission rejects the contention that the good faith negotiation rule is unfairly weighed in favor of producers because it does not permit purchasers to initiate the process and does not provide for renegotiation of new gas sold under separate contracts. The Commission accordingly declines to adopt any of the various suggestions to alter these features of the rule.

2. *Response to Other Suggested Clarifications and Modifications of the Good Faith Negotiation Rule.*

The Commission has now considered all of the major challenges to the legality of the good faith negotiation rule made by rehearing applicants. Applicants from all segments of the natural gas industry have, however, also requested numerous clarifications and alterations of specific aspects of the good faith negotiation rule. Most applicants seek to increase the bargaining rights of their segment of the industry. Since the Commission believes that bargaining rights under the rule as adopted are balanced, it generally rejects the suggested modifications. However, the Commission does make several minor changes in the rule.

The Commission will first consider (a) issues involving generally the three-step nomination procedure by which contracts are placed on the bargaining table for negotiation under the good faith negotiation rule. It will then discuss, in order, (b) issues specifically concerning the producer's right in step 1 to request that the purchaser nominate a new price for old gas, (c) issues concerning the purchaser's right in step 2 to request that the producer nominate a new price for any gas in the contract placed on the bargaining table in step 1 or any other contract including old gas, (d) issues concerning the producer's right to request that the purchaser nomi-

nate a new price for old gas in contracts brought to the bargaining table in step 2, (e) issues concerning the rule that no contract may be renegotiated more than once under the good faith negotiation rule, (f) issues concerning the parties' rights to abandon sales or terminate purchases of gas, and (g) issues concerning the operation of the good faith negotiation rule in certain specific situations.

a. *General Issues Concerning the Three-Step Nomination Procedure*

First, several applicants [185] request that the Commission postpone the start of negotiations under the good faith negotiation rule from November 1, 1986 to at least January 1, 1987. These applicants contend that otherwise old gas price increases and abandonment may occur during the winter heating season. Also, one contends that a delay will provide more time for resolution of Order No. 436 settlements, thus enabling both pipelines and their customers to make their pricing decisions based on more accurate knowledge of the market structure under which they will be operating. Finally, they express concern that good faith negotiation might start before the Commission acts on their rehearing requests.

The Commission has previously postponed the date on which a producer is permitted to make a nomination request until December 18, 1986 in order to assure that no party is required to renegotiate a contract under the good faith negotiation rule until the Commission has resolved the issues raised on rehearing.[186] In this order, the Commission further postpones the initiation of good faith negotiation until [insert date 30 days after publication of this order in the *Federal Register*]. The amendments to the good faith negotiation rule adopted in this order do not become effective until that date. This further postponement of the initiation of good faith negotiation will therefore avoid any confusion which might otherwise arise if the rule were changed after negotiation had already begun under it. The postponement of the initiation of good faith negotiation ensures that no abandonments or price increases not agreed to by the purchaser will occur during the winter heating season. The purchaser may prevent any abandonment from occurring until at least 90 days after the [insert date 30 days after publication of this order in the *Federal Register*] start of good faith negotiation, or [insert date 120 days after publication of this order in the *Federal Register*] and probably longer. A purchaser has up to 60 days to respond to a producer's nomination requests. If the producer rejects the price nomination, it must negotiate a contract with a new purchaser, and then give the purchaser 30-days notice before abandoning the sales to the purchaser. Furthermore, if the pipeline is a non-Order No. 436 pipeline and the new purchaser is not a firm sales customer of that pipeline, the producer must also give the firm sales customers a right of first refusal, a process taking an additional 30 days, before giving the 30-days notice of abandonment. The only price increases occurring under the good faith negotiation procedures significantly before [insert date 120 days after publication of this order in the *Federal Register*] would be those resulting from a producer's acceptance of the purchaser's price nomination.[187] Since such price increases are voluntarily agreed to by the purchaser, the Commission sees no reason to postpone their effect through further delaying initiation of the good faith negotiation rule. The Commission also does not believe that any further delay in the effectiveness of the good faith negotiation rule would significantly affect the number of pipelines whose Order No. 436 status has been clarified.

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[185] *See* Minnesota DPS at 8 and NI-Gas at 22-23.

[186] 37 FERC ¶ 61,077 (1986).

[187] These could occur by about 60 days after initiation of good faith negotiations, or [insert date 90 days after publication of this order in the *Federal Register*.]

A large number of applicants, primarily pipelines and distributors,[188] request that the Commission require that all producer requests for price nominations under the good faith negotiation rule be made within a specified period after the date when producers may initiate good faith negotiation. Many suggest one year as an appropriate period. The applicants contend that without this requirement producers might postpone exercising their rights under the good faith negotiation rule indefinitely, waiting for market conditions to improve so that they can obtain a greater increase in old gas prices while incurring a smaller decrease in new gas prices. This allegedly would permit the indefinite continuation of the present vintage-based rates found unjust and unreasonable in Order No. 451 in violation of NGA section 5, and postpone achievement of the Commission's goals of increased production of old gas and resulting lower overall prices. Also, purchasers' uncertainty over their supply arrangements allegedly would be indefinitely prolonged. Finally, when price increases did occur, they would be unreasonably large because obtained during a time of shortage.

The Commission has determined not to place a time limit on initiation of good faith negotiation. The purpose of this rulemaking is to create market-responsive pricing for old gas up to replacement costs. A limitation on when the producer can invoke good faith negotiation would be contrary to this goal. It is difficult to see any significant harm to an individual purchaser from a producer's delay is seeking renegotiation, since the purchaser is entitled to continue to buy the gas at the existing low price until renegotiation is sought. If the

[188] Tennessee at 24; PG&E at 5; Peoples Gas *et al.* at 24; Cal PUC at 28; SoCal at 2; Panhandle and Trunkline at 15; El Paso at 15; Northwest Central at 54; Transwestern at 16; AGA at 25; INGAA at 16; Texas Eastern at 19; Transco at 8; ANR and CIG at 23; D.C. PSC at 5; Arkla at 14; Florida Cities at 8; Arkla at 14; and Florida Gas at 22.

purchaser is concerned about security of supply, it can seek to enter long-term contracts with other sellers or offer voluntary renegotiation to the existing seller. Furthermore, the Commission anticipates that the effect of good faith negotiation nationwide will probably be a gradual phase-in of the higher old gas prices in an evolutionary fashion reflecting individual producer decisions on initiation and continued voluntary negotiation. An arbitrary time limit could force either premature initiation with a rush of good faith negotiation nationwide or in the alternative the loss of good faith negotiation rights by many producers unwilling to initiate the process before the deadline. The Commission wants to ensure that it provides fully for the evolutionary phase-in of higher old gas prices over time to maximize the price and supply responses. Finally, the Commission rejects the contention that NGA section 5 requires limiting the time in which the producers can initiate good faith negotiation in order to force elimination of current unreasonable rates. The Commission has found that the existing rigid vintage-based old gas pricing structure is unjust and unreasonable. By establishing the alternative ceiling price and permitting producers to seek higher prices under the good faith negotiation rule, the Commission has eliminated the existing rigid old gas pricing structure by permitting market-responsive pricing up to replacement cost. Having done that, the Commission should now let the market work and not interfere in it by specifying the time in which producers must exercise their rights.

Third, several applicants[189] request that the Commission clarify that a party requested to nominate a new price may also seek changes in the non-price terms of the contract. The Commission agrees that when a party is requested to nominate a new price, it may include in its nomination changes in any term of the contract. It would

[189] AGA at 35 n.44; INGAA at 17; Panhandle and Trunkline at 17; and ANR and CIG at 21.

be inconsistent with the Commission's goal of encouraging market-responsive pricing to limit the contract terms subject to renegotiation. Terms other than price can have a significant effect on the economic value of a bargain to either party.[190] Parties should not be restricted in the types of contract changes they can make in order to reach agreement on a new contractual relationship satisfactory to both. Accordingly, paragraph (a)(7) has been included in § 270.201, as revised.

However, the requirement that the producer accept the purchaser's nomination of the highest price permitted under the contract will not apply if the purchaser nominates the highest price permitted by the contract but includes in its nomination a change in another contract term. The reasons for requiring the producer to accept a nomination of the highest permitted price is that the purchaser has agreed to abide by the existing contract, which provides for payment of that price. If the purchaser seeks to change terms in the contract, then it has not agreed to abide by the existing contract. Furthermore, it would be improper to allow a purchaser to impose on the producer a change in any contract term by the simple expedient of including such change in a nomination of the highest permitted price. No change in the contract should occur other than through the mutual agreement of the parties.[191] Section 270.201(d) and (e) have been amended accordingly.

[190] This does not, however, make non-price terms part of the price paid under the contract. *See* Declaratory Order, Transportation of Liquid and Liquefiable Hydrocarbons by Natural Gas Pipelines, 22 FERC ¶ 60,013 (1983), *reh'g denied*, 24 FERC ¶ 61,004 (1983); *aff'd*, Texas Eastern Transmission Corporation v. FERC, 769 F.2d 1053 (5th Cir. 1985), *cert. denied*, 106 S. Ct. 1967 (1986).

[191] Tennessee contends (at 20-22) that the producer should at least be required to accept the purchaser's nomination where it nominates the highest permitted price but seeks insertion of a market-out clause. Tennessee argues that this would provide for more market-responsive pricing of gas in the future. For the reasons stated above, the Commission rejects this proposal. While the Commission recognizes the value of market-out clauses in encouraging market-responsive pricing, the Commission believes that insertion of such clauses into contracts should not occur through Commission fiat or the unilateral action of one party, but through mutual agreement of both parties in light of current market conditions. A party desiring a long-term agreement without a market-out clause should have the ability to negotiate for such agreement through offering appropriate inducements to the other party.

One applicant[192] requests that the Commission clarify the mechanics of requesting and making price nominations under the good faith negotiation rule. First, it suggests that both parties be required to send their requests for price nominations by U.S. mail, return receipt requested. Since the 60 days for responding to the nomination request run from the day of receipt, this requirement would enable the person making the request to know when the 60-day period begins to run. The Commission adopts this suggestion. Not only will this provision enable the sender to know the date of receipt, but also it is consistent with the requirements in § 270.201 (g)(2) and (3) that the tender of the right of first refusal and its acceptance be made by U.S. mail, return receipt requested. For the same reasons, the Commission similarly requires that responses to nomination requests and acceptance or rejection thereof, as well as notices of abandonment or termination of purchases, be made by U.S. mail, return receipt requested.[193]

Second, the applicant seeks clarification of when nominations should be considered as having been made. Consistent with the usual rule that service of a document is accomplished on the date it is deposited in the mail,[194] a party's price nomination will be considered made on

[192] Tennessee at 33-34.

[193] Accordingly, paragraph (a)(5) has been included in § 270.201, as revised.

[194] *See* 18 C.F.R. 385.2010(g)(1) (1986).

that date. Finally, the applicant asks to whom nomination requests and price nominations should be addressed and whether the contract's notice provision governs. The notice provision does govern. In the absence of such a provision, the parties should work out this matter among themselves.[195]

On applicant [196] states that the purchaser's price nomination in response to the producer's step 1 nomination request should be due on the same day as the producer's price nomination in response. to the purchaser's step 2 nomination request. The rule, as adopted, provides for the purchaser's price nomination to be made 30 days before the producer's. The applicant argues that this is unfair since it allows the producer to see the purchaser's nominated price before it nominates a price for the gas covered by purchaser's nomination request. The Commission rejects this proposal. While the producer can see the price nominated by the purchaser before nominating a price in response to the purchaser's step 2 nomination request, the purchaser can see the producer's nominated price before responding to the producer's step 3 nomination request. These sequential price nominations are inherent in the structure of the good faith negotiation rule, and the Commission does not believe that any imbalance in the parties' negotiating rights results.

b. *The Producer's Rights in Step 1*

A producer cannot request the purchaser to nominate a higher price under the good faith negotiation rule unless its contract provides authority for collection of the higher

[195] As the Commission stated in Order No. 451, parties may extend any deadlines for action under the good faith negotiation rule by mutual agreement. In response to an applicant's request (Indicated Producers at 22), the Commission has codified this right in § 270.201(a)(6) of its regulations.

[196] Northwest Central at 57.

price.[197] In Order No. 451 the Commission stated that if a contract contained an indefinite price escalation clause but the parties had executed an amendment providing for a fixed price lower than the applicable maximum lawful price for a set period less than the term of the contract, the producer could make a nomination request at any time but any new price agreed to would not take effect until expiration of the fixed price. An applicant [198] states that such amendments may be for indefinite periods, for example until further notice or until some benchmark price is reached. It requests that the Commission clarify the producer's rights under the good faith negotiation rule in such circumstances. The Commission believes that the same rule should apply regardless of whether the amendment is for a definite or indefinite period, but it has determined to modify the rule stated in Order No. 451 so that the producer may not request that the purchaser nominate a price until the fixed price amendment has expired pursuant to its terms. Thus, in the situation hypothesized by the applicant, no nomination request may be made until the necessary notice is given or the benchmark price is reached.[199] This rule is necessary to prevent the producer from obtaining a right to abandon sales through rejection of the purchaser's nominated price before it has contractual authority to increase prices. It is also consistent with the general principle that pro-

[197] § 270.201(a)(2)(ii)(A).

[198] ANR and CIG at 29.

[199] Of course, if the contract also covered some gas with a price ceiling lower than the price set in the fixed price amendment, the producer could, before the amendment expired, request that the purchaser nominate a higher price for that gas up to the price set by the amendment. However, such request would prevent the producer from making any subsequent nomination request under the good faith negotiation rule after the fixed-price amendment expired. *See* § 270.201(a)(4)(ii).

ducers must have contractual authority for higher prices in order to initiate good faith negotiation.[200]

A contract must have been in effect on July 18, 1986, in order to be renegotiated under the good faith negotiation rule. One producer applicant,[201] however, contends that where a producer signed a rollover contract before issuance of Order No. 451 but the contract had not been signed by the purchaser by July 18, 1986, signature by the purchaser after July 18, 1986, should not preclude the contract from renegotiation under the good faith negotiation procedures even though the contract was not in effect on July 18. Without this change, the applicant claims, the purchaser could deny the producer its right to renegotiation under the good faith negotiation rule by purposefully delaying signing the rollover contract. The Commission sees no reason to change the rule as suggested by this applicant. Once the Commission had issued Order No. 451 on June 6, the producer should have been as aware of its rights under Order No. 451 as the purchaser. If the producer wanted to reconsider its offer to the purchaser in light of Order No. 451 it should have withdrawn that offer. If it failed to do so, the purchaser would be entirely within its rights to sign the contract and a binding agreement would result not subject to renegotiation under the good faith negotiation rule.

One producer applicant [202] requests that the Commission modify the provision that the producer must accept the purchaser's nomination of the highest price

[200] This rule would not apply where the purchaser had imposed a unilateral price increase moratorium. In that case, since the producer had not agreed to the moratorium, the producer would retain contractual authority to collect a higher price and could initiate good faith negotiation any time after [insert date 30 days after publication in the *Federal Register*].

[201] Amoco Production Company (Amoco) at 8.

[202] Plains Petroleum Company (Plains) at 2-4.

permitted by the contract to make that provision inapplicable where that contract contains a market-out clause. The applicant contends that otherwise the provision would permit a purchaser to deprive the producer of its right to abandon sales or obtain transportation to an alternative purchaser by nominating the highest price and then, a month later, exercising the market-out clause to reduce the price of the gas. The Commission will not modify the good faith negotiation rule as suggested. The producer, having originally agreed to the market-out clause, should abide by the consequences of its agreement. Since market-out clauses encourage market-responsive pricing, the Commission sees no reason why it should interfere with their operation in a rulemaking designed to encourage market-responsive pricing. In any event, if the situation postulated by the applicant were to occur, the applicant would not be entirely without remedy. It could apply to the Commission for an individual abandonment pursuant to NGA section 7(b).

Finally, another producer applicant [203] requests that the Commission permit a producer, when it makes a nomination request in step 1, to stipulate that neither it nor the purchaser can make any nomination requests with respect to casinghead gas sold under contracts otherwise subject to the negotiations. Casinghead gas is a byproduct of oil production. The applicant's primary reason for desiring the right to exclude casinghead gas is apparently that a purchaser's termination of purchases of such gas under the good faith negotiation rule might adversely affect the producer's oil production. Conceivably, if the producer could not find an alternative purchaser for the casinghead gas, the producer could be required to shut in the oil production.

The Commission refuses to adopt the applicant's suggested modification of the good faith negotiation rule. It would be contrary to the Commission's goal of market-responsive pricing to allow the producer to insulate cer-

[203] Indicated Producers at 16.

tain gas from renegotiation. The producer should take into account any concern about the effect of abandonment on its oil production in deciding whether to initiate good faith negotiations and whether to accept the purchaser's nominated price. In addition, as will be described later, the Commission is lengthening the notice the purchaser must give the producer before terminating purchases. This should give the producer a greater opportunity to find another purchaser for the casinghead gas and avoid any loss of oil production. The Commission concludes that the suggested modification would add unnecessary complexity to the good faith negotiation rule.

c. *The Purchaser's Rights in Step 2*

A number of applicants request clarifications concerning precisely what contracts containing some old gas the purchaser may bring to the bargaining table in step 2. First, clarification is sought concerning precisely what gas is considered old gas for purposes of permitting the purchaser to put a contract on the bargaining table. For example, if a contract contains gas committed or dedicated to interstate commerce on the date of enactment of the NGPA which now receives the section 108 stripper price, could the purchaser bring that contract to the bargaining table in step 2?[204] The old gas must be actually priced under NGPA sections 104 and 106. Thus, a contract containing all new gas on July 18 except for some old gas priced under section 108 could not be brought to the bargaining table by the purchaser. The Commission's rationale for including contracts containing some old gas in step 2 would not apply in such circumstances since the purchaser could not be relying on low-priced section 104 or 106 gas to bring down the average price paid under the contract to reasonable levels.[205]

[204] *See* ANR and CIG at 26 and IPAA at 3.

[205] Paragraph (a)(2)(i) has been included in § 270.201, as revised, to clarify the definition of "old gas."

Second, one applicant[206] asks *when* the contract must contain old gas. It observes that a contract may have originally covered old gas but later all the old gas wells may either have qualified for NGPA incentive prices or been abandoned. It suggests that the Commission require that the contract cover old gas on the date the first seller makes his nomination request in step 1. The Commission agrees that to avoid ambiguity there must be a reference date for purposes of determining whether a contract covers old gas. However, the Commission believes that that date should be the effective date of this rule, July 18, 1986. This date will enable all parties to determine with certainty what contracts are potentially subject to good faith negotiation. It will also prevent a producer from insulating a contract from renegotiation by delaying initiation of the good faith negotiation procedures until all that contract's old gas wells are abandoned or qualify for NGPA incentive prices. A contract will be considered to cover old gas if on July 18, 1986 it covered any wells subject to the section 104 or 106 price ceilings for which the Commission has not authorized permanent abandonment. Thus, the mere fact no old gas was sold on that date does not necessarily mean that the contract does not cover old gas.[207] The requirement that abandonment have been granted should avoid disputes whether a well was only temporarily shut in or depleted.[208]

[206] IPAA at 2.

[207] Paragraph (a)(2)(ii)(B) is included in § 270.201, as revised, to resolve this ambiguity.

[208] For the same reasons, the expired contracts subject to renegotiation under the good faith negotiation rule will be considered to include all expired contracts as to which the Commission has not authorized abandonment as of July 18, 1986. Gas sold under the expired contract need not have actually been flowing on July 18, 1986. This rule provides certainty as to which expired contracts are subject to the good faith negotiation rule. The Commission recognizes that in some instances abandonment may not have been granted even though all gas well subject to the expired contract are

Third, one applicant[209] requests clarification whether, when a purchaser has contracts naming different divisions of a single corporation as the seller, and the producer makes a nomination request with respect to one division's contract, the purchaser may bring to the bargaining table the other division's contract in step 2. Another applicant[210] requests clarification that, where a producer has contracts with two affiliated corporations and requests one to nominate a price, the other may not seek renegotiation in step 2, of its contracts. The Commission believes that, for purposes of determining whether a "purchaser" has contracts with a "seller" containing some old gas subject to renegotiation in step 2, individual corporations should be considered single, but separate, sellers and purchasers. Thus, two divisions of one corporation are nevertheless the same seller, and the purchaser may bring to the bargaining table all contracts with both divisions. However, affiliated corporations with separate corporate identities are separate purchasers (or sellers), and contracts with one affiliate cannot be brought to the bargaining table in step 2 if only a contract with the other was brought to the bargaining table in step 1.

Fourth, one applicant[211] requests clarification whether an umbrella settlement covering many separate contracts, some containing old gas and some only new gas, is an existing contract subject to renegotiation in step 2. If such an umbrella settlement is an existing contract, the purchaser could seek to renegotiate the new gas contracts solely because the producer previously agreed to provide

depleted. However, in many such circumstances, neither party is likely to have an interest in renegotiating the contract in any event, and the rule should cause no hardship.

[209] El Paso at 20.

[210] Samson Resources Company (Samson) at 3-4.

[211] Indicated Producers at 29.

price or take-or-pay relief in the umbrella settlement. The Commission agrees that a producer should not be penalized for entering into such umbrella settlements. It intends that the phrase "existing contract . . . that includes the sale of any old gas"[212] should refer to base contracts, not umbrella settlements.

Fifth, two applicants request clarification whether a producer's request, after expiration of an existing contract, to collect the new ceiling price under a rollover or replacement contract triggers the purchaser's rights under step 2 of the good faith negotiation rule. Amoco[213] states that a producer's request for a rollover contract at the new ceiling price should not constitute a nomination request under the good faith negotiation procedures permitting the purchaser to obtain renegotiation of other contracts containing old gas in step 2. ANR and CIG,[214] however, take the opposite position, stating that the occurrence of a contractual rollover should constitute a request for a price nomination under the good faith negotiation rule to the extent the underlying contract contains an indefinite price escalation clause.

The Commission generally agrees with Amoco, not ANR and CIG. The good faith negotiation rule applies only to contracts (or the underlying service obligation) in effect on July 18, 1986. When a producer seeks to negotiate a rollover contract after July 18, 1986 to replace an expired contract, it is negotiating a contract not in effect on July 18, and the good faith negotiation rule in inapplicable. Negotiation of the rollover contract is entirely voluntary, and neither party thereafter has any rights under the good faith negotiation rule. If a producer and pipeline voluntarily enter a rollover contract, the execu-

[212] § 270.201(b)(2).

[213] at 8.

[214] at 28-29.

tion of the rollover terminates any further rights under the good faith negotiation rule.

Of course, old gas sales may be continuing under the expired contract pursuant to the service obligation of a certificate of public convenience or necessity. If the service obligation was in effect on July 18, 1986,[215] the producer may pursuant to the good faith negotiation procedures seek a higher price for old gas sold under an expired contract pursuant to the service obligation. However, if the producer does so, the purchaser may in step 2 seek renegotiation of all other contracts with the producer containing old gas. In the absence of the purchaser's agreement to a higher price either voluntarily or under the good faith negotiation procedures, the producer may not collect from the new ceiling price for gas sold pursuant to a service obligation. If the producer could collect up to the new ceiling price without the purchaser's agreement, there would be no assurance that the producer was obtaining mutually agreeable prices. This would violate the Commission's objective of permitting collection only of mutually agreed-upon prices or the ceiling price, whichever is lower.

Sixth, two applicants [216] express concern that some producers may seek to avoid renegotiation of their new gas in step 2 by transferring or assigning either their old gas or their new gas to an affiliated entity so that all new and old gas is in separate contracts. The Commission does not believe that this is a significant danger under the rule as adopted. More assignment to another corporate entity of old or new gas covered by a multi-vintage contract without amendment of the sales contract itself could not insulate the new gas from renegotiation in step 2. This is because the original owner of the gas would still appear

[215] Even if the contract expired after July 18, 1986, the service obligation is considered to have been in effect on that date so long as the contract was in effect on that date.

[216] ANR and CIG at 22 and Arkla 12.

on the contract with the purchaser as the seller of that gas. The purchaser is entitled to obtain renegotiation in step 2 of all gas sold under the contract as it was on July 18, 1986, by the seller regardless of whether the seller claims someone else owns the gas. Furthermore, if the contract were amended after July 18, 1986, to reflect the assignment, the amendment would deprive the producer of any rights under the good faith negotiation rule in any event, unless both the producer and the purchaser mutually agreed in writing to preserve their rights under the good faith negotiation rule.[217]

Finally, the provision for purchasers to make a nomination request in step 2 with respect to the same gas subject to the seller's step 1 nomination request [218] has caused confusion among some rehearing applicants. Some applicants appear to believe that a purchaser's request that a producer nominate a price for old gas covered by the producer's nomination request relieves that purchaser of its obligation to nominate a price in response to the producer's nomination request, thus depriving the producer of the opportunity to accept or reject a price nomination by the purchaser.[219] One applicant requests that the Commission amend the rule to eliminate any right by the purchaser in step 2 to request the producer to nominate a price for gas covered by the producer's step 1 request.

The Commission permitted purchasers to make nomination requests with respect to gas covered by the pro-

[217] The Commission disagrees with Arkla's concern about possible circumvention between the June 6, 1986 issuance of Order No. 451 and July 18, 1986, since, as noted above, purchasers had the ability to protect themselves during that period by refusing to agree to contract amendments. Purchasers should have been as aware of their step 2 rights during that period as sellers. In addition, there is no evidence that sellers sought to separate a significant amount of new gas from old gas during that period.

[218] 51 Fed. Reg. at 22,208, note 261.

[219] *See* Indicated Producers at 31-32 and Amoco at 8-9.

ducer's request so that purchasers and producers would have identical bargaining rights with respect to old gas. Without this provision, the producer could foreclose the purchaser from obtaining a lower price for, or terminating purchases of, any old gas by including all such gas in its nomination request in step 1. Even if the purchaser nominated a price lower than the existing contract price in response to the producer's nomination request, the producer could simply reject the purchaser's nomination and continue sales at the existing contract price. Accordingly, the Commission believes that this provision should be retained. However, the Commission does not clarify that a purchaser's request in step 2 that the producer nominate a price for old gas covered by the producer's request in step 1 does not relieve the purchaser of its obligation to nominate a price in response to the producer's request. Rather, in such circumstances negotiations must continue under the good faith negotiation rule until either (1) one party has accepted the other's price nomination resulting in a binding contract at the accepted price or (2) both parties have rejected the other's price nomination resulting in each having the right to terminate sales or purchases.

d. *The Producer's Rights in Step 3.*

One applicant [220] requests that the Commission permit a producer in step 3 to request that the purchaser nominate a price for any gas, including new gas, which the purchaser introduced in step 2. Under the rule as adopted, the producer may only request that the purchaser nominate a price for any *old* gas covered by the contracts the purchaser brought to the bargaining table while the purchaser can make nomination requests with respect to both old and new gas. The applicant alleges that the suggested change would make the parties' bargaining rights more balanced, since the fact that only

[220] Indicated Producers at 15-16.

the purchaser can renegotiate both old and new gas means only it can threaten to terminate the contract with respect to both old and new gas if dissatisfied with the producer's nominated price. The Commission does not adopt the suggested modification. Since new gas is mostly high priced, it would appear that the producer would gain little additional bargaining power by threatening to discontinue sales of that gas. Any benefits to be gained by giving the producer this right would be outweighed by the increased cumbersomeness of the rule. In any event, the Commission believes that the bargaining rights of the parties under the good faith negotiation rule, as adopted, are appropriately balanced.

e. *The Rule That No Contract May Be Renegotiated More Than Once Under The Good Faith Negotiation Rule*

Numerous applicants request various clarifications and modifications to the provision of the good faith negotiation rule as adopted by Order No. 451 that an existing contract may not be renegotiated under the good faith negotiation rule if the parties "have renegotiated the price or any other terms for the sale of any old gas under the contract after July 18, 1986, with or without using the good faith negotiation procedures of this section." [221] First, a number of applicants [222] state that the blanket nature of this provision could cause the unnecessary deferral of routine contract amendments necessary for operational reasons, such as changes in delivery points, quality specifications, and billing procedures. It could also discourage other beneficial amendments such as take-or-pay settlements. This is because a producer would be reluctant to enter into any contract modifications, no

[221] § 270.201(a)(3)(ii), as adopted by Order No. 451.

[222] Indicated Producers at 24; Panhandle and Trunkline at 17; Transwestern at 22; INGAA at 17; Florida Gas at 26; and NGA at 34.

matter how minor, until it had reviewed its contracts with the purchaser to determine the consequences of the loss of its rights under the good faith negotiation rule.

In response to Indicated Producer's emergency motion to clarify § 270.201(a)(3)(i) in order to resolve this problem, the Commission issued an interim order on rehearing on July 17, 1986. In that order, the Commission amended § 270.201(a)(3)(i), subject to further consideration in the rehearing order, to permit parties amending their contract after July 18, 1986, mutually to consent to preserve their rights under the good faith negotiation rule. The Commission continues to believe that this is the correct solution to the problem raised by the applicants and reaffirms the amendment made in the interim order on rehearing.[223]

The purpose of § 270.201(a)(3)(i) as adopted in Order No. 451 was to encourage voluntary renegotiation of contracts in light of the new ceiling price as a substitute for negotiation under the good faith negotiation rule. Without some such provision, purchasers who voluntarily renegotiated contracts with their producers would be subject to requests for further renegotiation under the good faith negotiation rule. In such circumstances, purchasers might well be reluctant to renegotiate their contracts voluntarily. The amendment adopted in the interim rehearing order avoids deterring such voluntary negotiation, since the producer would retain its rights under the good faith negotiation rule only if the purchaser so agreed. At the same time, it accomplishes the goal of permitting parties, if they desire, to make routine or, for that matter, substantial amendments without loss of their rights under the good faith negotiation rule.[224]

[223] This provision now appears in paragraph (a)(4)(i) of § 270.201, as revised.

[224] One party (IPAA), in a motion for reconsideration filed August 13, 1986, requests that the Commission modify the amendment adopted in the interim rehearing order to provide that parties voluntarily amending a contract *retain* their rights under the good faith negotiation rule unless they mutually agree in writing to waive those rights. IPAA claims that the amendment as adopted may permit a purchaser to trick an unsophisticated producer into loss of its rights under the good faith negotiation rule by proposing a minor contract amendment and not informing the producer of the necessity to expressly preserve or lose its rights under the good faith negotiation rule. IPAA also notes that some contract amendments are so minor that parties may not recognize them as renegotiations involving potential loss of rights under the good faith negotiation rule. The Commission declines to adopt IPAA's proposed change in the amendment adopted in the interim order on rehearing. The Commission believes that participants in a regulated industry such as the natural gas industry will become sufficiently familiar with the relevant regulations, and will be able to protect their interests. All persons have constructive, if not actual, notice of all duly published regulations, and as business participants in the natural gas arena, should be aware of possible loss of their rights under the good faith negotiation rule if they amend their contracts. Thus, producers can protect their own interests. However, the Commission is concerned about possible sharp practices by pipelines with respect to small producers hypothesized by IPAA. If such a case presents itself, the Commission may address the matter in the context of that concrete circumstance.

The other solutions to the problem suggested by applicants are not adopted since each would either deter voluntary renegotiation or fail to solve the problem. These suggestions are as follows:

1. Delete section 270.201(a)(3)(i), thereby allowing producers to invoke their rights under the good faith negotiation procedures, regardless of whether they have previously renegotiated existing contracts for the sale of old gas informally. This suggestion would deter voluntary negotiations because it would enable producers potentially to secure economic concessions for the sale of old gas one time through informal, voluntary negotiations and a second time under the formalities of the good faith negotiation rule.

2. Delete the phrase "or any other terms" from the clause in question, so that only informal renegotiations

of the *price* of old gas after July 18, 1986, would bar subsequent resort to the good faith negotiation procedures. This suggestion deters voluntary renegotiation because it would permit producers to exact economic concessions under existing contracts without technically increasing the price of old gas, and later seek price increases under the good faith negotiation procedures.

3. Establish the date when producers may initiate good faith negotiations,[225] rather than July 18, as the date after which informal amendments to existing contracts would preclude subsequent resort to the good faith negotiation procedures. This proposal, however, would continue to stifle minor contract changes after [insert date that is 29 days after publication of this order in the *Federal Register*] since no change could be made after that date without loss of rights under the good faith negotiation ru'e.

Two applicants[226] request clarification that § 270.201 (a) (4) (i)[227] does not operate to deprive producers of their rights under the good faith negotiation rule when there is a price change as a result of a preexisting contract clause. Examples of such contract clauses are price redetermination clauses which call for establishment of a new price at periodic intervals, either by some previously stipulated formula or by negotiation, and inflation adjustment clauses providing for monthly or quarterly automatic price escalations. The Commission believes that when a contract provides for an automatic price change pursuant to a stipulated formula so that no additional negotiations between the parties are required to

[225] Formerly November 1, 1986, now [insert date 30 days after publication of this order in the *Federal Register*.]

[226] Indicated Producers at 27; IPAA at 4.

[227] This provision was in paragraph (a) (3) (i) of § 270.201 in Order No. 451, but now appears in paragraph (a) (4) (i) in § 270.201, as revised.

determine the price, then § 270.201 (a) (4) (i) does not operate to deprive the producer of its rights under the good faith negotiation rule. No voluntary renegotiation has occurred. However, if the contract clause requires negotiations to establish a new price, then voluntary renegotiation has occurred and section 270.201 (a) (4) (i) does apply. The parties could, of course, mutually agree in writing to preserve their rights under the good faith negotiation rule.

Finally, one applicant[228] contends that § 270.201 (a) (3) (i), while prohibiting producers from making nomination requests under the good faith negotiation rule with respect to a contract voluntarily amended after July 18, 1986, unfairly permits purchasers to make nomination requests with respect to such contracts. Although the rule as adopted technically permits the applicant's interpretation, the Commission did not intend to permit purchasers to make nomination requests in such circumstances. Accordingly, the Commission further amends § 270.201 (a) (3) (i), now paragraph (a) (4) (i), in order to clarify its intent in this regard.

f. *Abandonment Under The Good Faith Negotiation Rule*

Numerous applicants seek clarification and modification of the provisions of the good faith negotiation rule concerning abandonment. The most significant issue concerning abandonment is the effect of abandonment on a purchaser's take-or-pay obligations under the existing contract. In particular, numerous pipelines, distributor, and consumer representative applicants[229] observe that a

[228] Indicated Producers at 28-29.

[229] PG&E at 7; NI-Gas at 19; SoCal at 8; El Paso at 14, 18; Panhandle and Trunkline at 14; Transwestern at 21; INGAA at 16; Natural and United at 12; Texas Eastern at 24; Transco at 8; ANR and CIG at 24; Florida Gas at 24; Tennessee at 18; UDC at 94; Northwest Central at 55; and AGA at 32.

purchaser at the time of abandonment may, pursuant to its take-or-pay obligation, have paid for gas but not taken it. However, the contract may provide the purchaser a chance to make up that gas over a particular period which has not yet expired. Most applicants request that the Commission require that in such circumstances the producer repay the take-or-pay payment if abandonment occurs under the good faith negotiation rule. Barring that requirement, the applicants desire that the Commission at least require that the purchaser's make-up rights under the contract survive the abandonment. The applicants also state that at the time of abandonment the purchaser may be subject to an accrued obligation to make a take-or-pay payment, but it may not yet have made the payment. Most applicants request that the Commission state that the purchaser is relieved of any accrued obligations to make take-or-pay payments upon abandonment. Applicants contend that the requested clarifications would avoid any inequity resulting from allowing procedures to be paid twice for the same gas, first when they collect take-or-pay payments and second when they sell the gas to a new purchaser after release.

The Commission does not believe it appropriate to establish procedures as to how the parties' take-or-pay obligations are affected when a contract is terminated under the good faith negotiation rule. The Commission believes that resolution of such obligations is part of the renegotiation process and disputes should be settled in accordance with the respective state laws governing the administration of contracts.

Pipeline, distributor, and consumer representative applicants suggest a number of other changes to the abandonment provisions of the good faith negotiation rule to prevent unfairness to them. Several applicants [200] request that the Commission limit the time within which either

[200] *See* El Paso at 15-16, and Arkla at 14-16.

party may exercise its right to abandon sales or terminate purchases. For example, some applicants propose that a party be required to exercise its right of abandonment within one year of the accrual of that right through its rejection of the other party's price nomination. Essentially, the applicants argue that allowing a party to reserve its abandonment right indefinitely would create unnecessary uncertainty for the other party and make future planning by that party difficult. The Commission believes that such a limitation on the parties' abandonment rights would be an unnecessary interference in the marketplace and refuses to adopt it. The primary concern of the applicants is with a pipeline waiting for its producer to abandon sales to the pipeline. While a producer's failure to exercise its abandonment rights for an indefinite time might cause the pipeline some uncertainty, it would also benefit the pipeline since sales would continue at the existing low price until abandonment occurred. Furthermore, given this fact, the Commission believes most producers have a strong incentive to exercise their abandonment rights expeditiously. Therefore, in most cases the problem of the pipeline being placed in indefinite uncertainty should be avoided.

Order No. 451 requires that, before the producers can abandon sales, it must enter into a contract to sell to a third party. In the notice of proposed rulemaking, DOE proposed that the Commission require that the new contract be for a higher price than that nominated by the existing purchaser and be for a term of at least two years. The Commission did not adopt these requirements. Several applicants [201] contend that the Commission should reinstitute these requirements. They contend that the Commission erred in finding these provisions unnecessary since producers are unlikely to sell to another purchaser unless they can obtain a better bargain. They argue that

[201] Northern Distributor Group (NDG) at 14; Northern Natural at 34; ANR and CIG at 16; Northwest Central at 53.

a producer may sell gas to a third party in a short-term agreement at a price less than that nominated by the existing purchaser solely for the purpose of freeing itself from its existing service obligation. Then, when market prices rise, it would be in a position to collect the higher prices. In the interim between expiration of the short-term agreement and higher market prices it might even shut in the gas. Two applicants [232] observe that a sale at a lower price might be more valuable to the producer in any event if the new purchaser agreed to take more volumes and that the new purchaser might well be able to take more than the existing pipeline purchaser.

The Commission continues to believe that the two-year and higher price requirements are unnecessary and unwise. As stated in Order No. 451, those requirements are inconsistent with the Commission's objective of encouraging market-responsive natural gas contracts. The two-year requirement would effectively prohibit market-out clauses for that period. Such clauses have been instrumental in permitting pipelines to reduce their purchased gas costs in recent years. Furthermore, if the Commission required that new contracts be for a higher price, it would also have to prohibit the existing purchaser from nominating any change in the contract other than price. Otherwise, it would be difficult to determine whether the new purchaser's offer was, in fact, worth more to the existing producer, since non-price terms may have a significant effect on the economic value of a bargain. Numerous applicants have stressed the importance of permitting existing purchasers to nominate changes in contract terms other than price as enabling them to renegotiate unfavorable non-price terms in existing contracts.

Even if there is danger that some producers may enter short-term contracts at lower prices to eliminate

[232] ANR and CIG at 17.

their service obligations, the Commission believes that that damper is outweighed by the interest in permitting parties to negotiate new contracts freely without restriction as to the terms they can negotiate. In any event, the Commission continues to believe that producers are unlikely to sell to a third party at terms less favorable than those offered by the existing purchaser. Furthermore, the Commission notes that the increased bargaining power Order No. 451 grants purchasers with respect to higher-priced new gas should enable purchasers to negotiate more effectively to keep the lower-priced old gas. Finally, the producer cannot sell to non-firm sales customers of a non-Order No. 436 pipeline without giving the firm sales customers a right of first refusal. If a producer were to arrange a sale to a third party at an artificially low price solely to eliminate its service obligations, the firm sales customers could benefit from the lower price through exercise of the right of first refusal.

Two pipeline applicants [233] request that the Commission limit the term of any abandonment under the good faith negotiation rule to two years, but provide that the abandonment will become permanent at the end of that period if the parties do not then reach agreement for producers an opportunity to sell to another purchaser in the spot market over the next several years, during which the natural gas surplus deliverability is expected to continue, but will give pipelines an opportunity to protect their historic access to these valuable supplies at the end of that period when the surplus is likely to be largely dissipated. The Commission refuses to adopt this proposal. The good faith negotiation rule, as adopted, gives the purchaser ample opportunity to negotiate to keep the gas when responding to the producer's nomination request. Giving the pipeline an automatic right under the good faith negotiation rule to regain the gas two years later after abandonment would create unnecessary

[233] ANR and CIG at 18-20.

uncertainty.[234] It would also prevent the producer from negotiating a long-term contract with another purchaser in violation of the Commission's goal of maximizing the parties' rights to freely negotiate concerning old gas.

Finally, the same two pipeline applicants[235] request that the Commission state that a pipeline will not be deemed negligent for the loss of gas pursuant to the abandonment provisions of the good faith negotiation rule, even though the pipeline later has to curtail sales because of a shortage of supplies. The applicants state that, because of current market conditions, pipelines may not be able to nominate a high enough price to keep all their old gas. However, in the future, market conditions may change and shortages occur. It would be unfair in such circumstances, the applicants claim, to hold the pipeline negligent for any resulting curtailments. The Commission can make no blanket statement concerning a pipeline's liability for future claims of negligence based on events which have not yet occurred. The Commission assumes that parties will negotiate in good faith based on current and forseeable market and supply conditions. To the extent a pipeline acts prudently and in good faith to do what is in the best interests of its customers, the Commission would not intervene at a later date to hold that pipeline negligent for unforseeable events. The Commission cannot, of course, speculate on how a court would decide any negligence suit brought to it.[236]

Producer applicants also claim that various provisions of the good faith negotiation rule must be modified to

[234] Of course, the pipeline could seek a limited-term abandonment of the type granted in *Southern Natural Gas Co.*, 36 FERC ¶ 61,401 and *Transcontinental Gas Pipe Line Corp.*, 36 FERC ¶ 61,403 if its producers voluntarily agree.

[235] ANR and CIG at 20.

[236] *See* Opinion No. 248, 35 FERC ¶ 61,043, *reh'g denied*, 35 FERC ¶ 61,340 (1986).

prevent unfairness to them. One producer applicant[237] contends that the 30-days notice purchasers must give producers before terminating purchases is too short. The applicant states that because of various factors, including the difficulty of finding purchasers for the relatively small packages of gas which may be released and of arranging transportation to the new purchaser, thirty days is generally too short a time in which to arrange new sales. As a result, the gas is likely to be shut in before a new purchaser is found. Such shut-ins allegedly cause serious operational difficulties for producers. Neighboring wells belonging to other producers may drain the shut-in well. The well might not produce when reopened. The leases may be terminated for cessation of commercial production. The applicant notes that these problems do not arise when the producer abandons sales to the purchaser, since the producer cannot abandon sales until it has arranged for a new sale. The applicant requests that the Commission require that the purchaser give the producer at least 120 days before terminating purchases.

The 30-days notice that Order No. 451 requires purchasers to give producers before terminating purchases is the same notice that the producer must give the purchaser before abandoning sales. Thus, the purchaser has the same time in which to arrange to purchase replacement supplies as the producer has to arrange to sell to an alternate purchaser. The purchaser, too, may have difficulties in arranging to purchase from another producer. Thus, the Commission is reluctant to lengthen the notice the purchaser must give the producer before terminating purchases. However, the Commission does recognize that the producer has one difficulty that the purchaser does not face. The producer must give a pipeline's firm sales customers a right of first refusal before selling to any other purchaser. This process takes up to thirty days it-

[237] Indicated Producers at 9-15.

self after an agreement has been entered into with the alternative purchaser. Therefore, if the producer seeks to sell to a purchaser other than a firm sales customer of the pipeline, it would be virtually impossible for it to arrange the sale within the 30-days notice given by the original purchaser of the termination of purchases. A pipeline receiving notice of abandonment of sales by the producer does not face this problem in arranging to purchase gas from another producer. There is generally no right of first refusal with which it must comply. In light of these facts, the Commission has determined to lengthen the notice the purchaser must give the producer before terminating purchases to 60 days to give more time for the producer to arrange another sale. Section 270.201(c)(2) and (f)(3) are amended accordingly. The notice the producer must give the purchaser will remain at 30 days.

The same applicant[238] also requests that the Commission eliminate the requirement that the producer enter into a contract to sell the gas to a third party before abandoning sales to the original purchaser. The applicant states that this requirement is unfair since there is no comparable requirement applicable to purchasers when they terminate purchases. In addition, the applicant suggests that the producer's ability to abandon sales without having arranged for a new purchaser would give it additional bargaining power to obtain agreement from the purchaser that neither will terminate sales or purchases until both have made alternate arrangements. The Commission rejects this proposal. The purpose of the requirement that the producer contract to sell the gas to another party is to assure that the old gas with its relaively lower price continue to flow to the market-place. There is no similar policy reason for imposing a comparable requirement on purchasers that they arrange to purchase gas from another producer before terminating purchases from the first producer.

[238] Indicated Producers at 14.

Finally, a number of applicants from all segments of the natural gas industry request that the Commission expand the abandonment permitted under the good faith negotiation rule in various ways. First, two pipeline applicants[239] request that the Commission provide for abandonment, at the request of the purchaser, of gas under any contract which has expired and cannot be renegotiated. The applicants state that there are many expired jurisdictional contracts with terms favorable to the producer for which purchasers have been seeking to renegotiate rollover contracts. However, the producers have no incentive to renegotiate such rollover contracts since in the absence of abandonment the purchaser allegedly must continue purchasing gas under the unfavorable terms of the expired contract. The Commission sees no need to modify the good faith negotiation rule to deal with this situation. If the producer requests that the purchaser nominate a price with respect to any contract with a purchaser, the purchaser could seek renegotiation of the expired contract in question.[240] If dissatisfied with the producer's nomination, it could terminate purchases under the contract. If the producer does not make a nomination request with respect to any contract, the only way to deal with the problem raised by the applicants through the good faith negotiation rule would be to permit the purchaser to initiate negotiations under the rule. The Commission refuses to do that for the reasons discussed above at page 124-28.

Second, four pipeline and distributor applicants[241] request that the Commission provide for abandonment when the parties voluntarily agree to it as part of a voluntary renegotiation outside the scope of the good faith negotia-

[239] El Paso at 15-16 and Florida Gas at 20-22.

[240] Since the contract is subject to the Commission's NGA jurisdiction it likely contains some gas priced under section 104 or 106(a).

[241] El Paso at 19; Natural at 11; Arkla at 6; AGA at 40.

tion rule.[242] These applicants contend that such abandonment would be consistent with the Commission's desire to encourage renegotiation. Without providing for such abandonment, if the parties entered into a voluntary agreement involving abandonment, parties would either have to file an individual application or proceed through the good faith negotiation procedures. The Commission refuses to provide the additional abandonment authority to cover this situation. Such abandonment would provide a means for the parties to avoid granting the pipeline's firm sales customers a right of first refusal, unless the Commission also required that the producer grant the firm sales customers a right of first refusal in such circumstances. In any event, there is no significant hardship in requiring the parties either to apply for an individual abandonment or a blanket limited term abandonment of the type granted in *Southern Natural Gas Co.*, 36 FERC ¶ 61,401, or go through the good faith negotiation procedures. The abandonments would likely be granted since unopposed and no fee would be required.

Third, one producer applicant [243] proposes that the Commission provide pre-granted abandonment and transportation rights similar to those provided under the good faith negotiation rule where the parties agree under the good faith negotiation procedures to include a bilateral market-out clause in their contract and one of the parties later terminates purchases pursuant to such a clause. The applicant contends that, without such rights, producers might be reluctant to accept a purchaser's price nomination with a market-out clause, since the purchaser could later exercise that right, and the producer would have lost its rights under the good faith negotiation rule to abandon sales and market the gas elsewhere. The Commission rejects this proposal as unwise in policy and add-

[242] AGA would limit such abandonment to gas previously priced higher than the pipeline's WACOG

[243] Amoco at 7.

ing unnecessary complexity to the good faith negotiation rule. The Commission believes that the parties themselves should negotiate any changes in their contractual relationship. These changes include insertion of market-out clauses and the conditions which must be met for such clauses to be exercised. Therefore, the Commission will not require for example, that pipelines exercising a market-out clause must transport the released gas. A producer with the concerns outlined above should seek the pipeline's agreement not to oppose abandonment and to transport the released gas if the pipeline exercises the market-out clause. Absent such agreement, the producer could refuse the pipeline's price nomination if it includes a market-out clause. In addition, the Commission observes that if the purchaser terminates purchases pursuant to a market-out clause agreed to under good faith negotiation procedures, the producer can seek abandonment from the Commission.

Fourth, one applicant [244] requests that the Commission permit the purchaser to terminate its contract with the producer within 180 days after the producer's rejection of the purchaser's nomination. The applicant expresses concern that, if the purchaser does not have this right, a producer could reject the purchaser's nomination and continue sales indefinitely at the existing price while waiting for gas prices to firm up. The purchaser would be unable to purchase alternative supplies because of its contractual obligation to the producer, but nevertheless could lose the gas sold it by the producer at any time. There is no need to amend Order No. 451 as suggested by the applicant, since purchasers already have the ability to prevent occurance of the situation described by the applicant. If a purchaser did not desire to continue its existing contractual relationship with the producer in the event the producer rejects its price nomination, it may in step 2 request that the producer nominate a price for the gas

[244] NI-Gas at 18.

covered by the producer's step 1 request.[245] It can then either accept the producer's nomination or reject the nomination and terminate purchases.

Finally, another applicant [246] expresses concern that the good faith negotiation rule may permit a purchaser, after rejecting the producer's price nomination requested in step 2, to terminate purchases of all relatively high-cost post-1974 and new gas, without foregoing its contractual right to purchase that gas, while simultaneously continuing to purchase the cheaper pre-1975 old gas. The applicant suggests that the Commission prevent such a situation from arising by providing that the contract is automatically terminated whenever the purchaser discontinues any purchases. The Commission believes that the applicant's concern is unjustified. If the purchaser terminates purchases of any gas, the terms of the existing contract no longer apply to that gas and the producer may sell that gas to another party.[247] It is true that the purchaser's termination of purchases of some gas does not affect the producer's obligation to sell to the purchaser all other gas covered by the contract. However, the producer has the right under the good faith negotiation rule to request the purchaser to nominate a price with respect to any old gas. If dissatisfied with the price nominated, it may abandon sales of that gas. Accordingly, there is no reason to believe that a pipeline would be able to selectively terminate purchases of high-cost gas but require the producer to continue sales of cheap old gas.

[245] *See* discussion *supra* at 151-52.

[246] Amoco at 8.

[247] *See* § 270.201 (f) (4) and (5).

g. *Operation of the Good Faith Negotiation Rule With Respect to Multiple Working Interest Owners, Natural Gas Processing Plants, and Advance Payment Contracts.*

Four applicants request that the Commission clarify the operation of the good faith negotiation rule when a number of persons own undivided interests in a lease, yet all the gas is sold under a single contract to the purchaser. Before discussing this issue, the Commission observes that multiple working interest owners generally enter into an operating agreement governing the operation of their lease. The operating agreement names one of their number or a third party as the operator of the lease. In the operating agreement, some working interest owners may authorize the operator to enter into sales contracts on their behalf. These owners thus do not sign the sales contract [248] and are referred to as non-signatory co-owners of the lease. Other working interest owners, however, do not authorize the operator to contract on their behalf, but join in and sign the same contract signed by the operator. These owners are referred to as signatory co-owners of the lease.

One producer applicant [249] requests that the Commission clarify that the operator's nomination request in step 1 affects only its working interest and not those of the non-signatory parties represented by it. This applicant is concerned that an operator's step 1 nomination request might permit the purchaser in step 2 to bring to the bargaining table all its contracts with a non-signatory co-owner, even though that owner did not desire to initiate good faith negotiation with respect to the first contract or any other contract. Another producer applicant [250] requests that the Commission clarify that each

[248] The sales contract may indicate that the operator is acting on their behalf and name them.

[249] Indicated Producers at 27.

[250] Samson at 5-6.

signatory co-owner may proceed separately under the good faith negotiation rule. In addition, it states that, where only one signatory co-owner initiates good faith negotiation the purchaser should not be able in step 2 to bring to the bargaining table the gas of any other co-owner even though that gas is sold under the same contract as the first co-owner's. Two pipeline applicants, however,[251] ask that the Commission state that where there are multiple working interest owners, all must initiate good faith negotiation together or not at all. Otherwise, they claim, pipelines will be faced with difficult operational problems if one co-owner obtains abandonment under the good faith negotiation rule and sells to a third party but other co-owners continue to sell to the pipeline. Another pipeline applicant [252] simply requests clarification how the good faith negotiation rule works when there are multiple working interest owners without taking a position as to how it should work.

The Commission recognizes that the good faith negotiation rule, as adopted in Order No. 451, is ambiguous concerning the rights of multiple working interest owners. Accordingly, it has amended the rule to clarify these rights as explained below.[253] Generally any co-owner of a lease with a direct contractual relationship with the purchaser is treated as having a separate contract with the purchaser and may initiate good faith negotiations separately without implicating the gas of other co-owners. A co-owner who has authorized another to contract on his behalf has no direct contractual relationship with the purchaser and may not initiate the good faith negotiation procedures. Its gas becomes subject to good faith

[251] Panhandle and Trunkline at 16.

[252] Tennessee at 34.

[253] Paragraph (2) (2) (iii) has been included in § 270.201, as revised, and the language now appearing in paragraph (a) (4) has been revised.

negotiation only through the good faith negotiations of the person contracting on its behalf. In other words, its gas is treated as if owned by that person.

Therefore, since each signatory co-owner has a direct contractual relationship with the purchaser, each may initiate good faith negotiations separately. If one signatory co-owner does so, then in step 2 the purchaser may bring to the bargaining table only that co-owner's gas, sold under the contract covered by the initial request or under other contracts containing old gas to which that co-owner is also signatory. Following completion of the three-step nomination procedure, neither the co-owner nor the purchaser may make further nomination requests under the good faith negotiation rule with respect to that co-owner's gas sold under any contract which either brought to the bargaining table. However, the other signatory co-owners may at any time make nomination requests with respect to their gas, and the purchaser will have the same rights with respect to their gas as it did with respect to the first co-owner's.

Non-signatory owners are treated differently since they do not have a direct contractual relationship with the purchaser. Because they have authorized the operators to contract on their behalf, they cannot make nomination requests under the good faith negotiation rule. However, any nomination by the operator must cover the gas of the non-signatory co-owners represented by it, as well as its own gas. When the operator makes a nomination request, the purchaser may in step 2 request that the operator nominate a new price both for its gas and that of any non-signatory co-owners sold under the contract brought to the bargaining table by the operator. The purchaser also may request that the operator nominate a price both for its gas and that of non-signatory co-owners sold under any other contract with the operator containing old gas. This includes the gas of non-signatory co-owners not included in the first contract. However, the

purchaser cannot request that the operator nominate a new price for any other gas of the non-signatory co-owners not covered a contract with the operator.

Following completion of the three-step nomination procedure, neither the operator nor the purchaser may make subsequent nomination requests under the good faith negotiation rule with respect to the gas of the operator and non-signatory co-owners sold under contracts which either the operator or purchaser brought to the bargaining table. However, other signatory co-owners may at any time make nomination requests with respect to their gas and the purchaser will then have the same rights with respect to their gas which it previously had with respect to that of the operator and the non-signatory co-owners. In short, the operator is treated like any other signatory co-owner except that the gas of the non-signatory co-owners on whose behalf it contracted is treated as if owned by the operator.

The operation of these procedures may be illustrated by the following example. Both old and new gas from three leases is sold to a single purchaser under three separate contracts. The operators and other working interest owners of the leases are as shown on the diagram in the margin.[254] Either A, B, or C may initiate good

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[254]

Lease 1
Operator = A
Signatory Co-owners
= B and C
Non-Signatory Co-owners
= D and E

Lease 2
Operator = A
Signatory Co-owner = E
Non-Signatory Co-owners
= B, D and F

Pipeline Purchaser

Lease 3
Operator = D
Signatory Co-owner = B
Non-Signatory Co-owners = A and E

faith negotiation with respect to Lease 1. D and E, however, as non-signatory co-owners, may not make nomination requests with respect to that issue.[255] If B, as a signatory co-owner of Lease 1, requests that the purchaser nominate a new price for its old gas sold under the Lease 1 contract, the purchaser may request that B nominate a new price for any of B's gas sold under the Lease 1 and 3 contracts. It may not make a nomination request with respect to any other gas sold under these contracts. Nor may it make a nomination request with respect to B's gas sold under the Lease 2 contract, since B is only a non-signatory co-owner of that lease.

Any price agreed upon between the purchaser and B will apply only to B's gas. The existing price will continue to apply with respect to the other working interest owners' gas. Similarly, if B and the purchaser fail to reach agreement and one abandons sales or purchases, the abandonment will apply only to B's gas.[256] Neither B nor the purchaser any subsequently renegotiate the price of B's gas in Leases 1 and 3 under the good faith negotiation rule. However, all other gas remains subject to renegotiation under the good faith negotiation rule, including B's gas in Lease 2.

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[255] Of course, E as a signatory co-owner of Lease 2 could request the purchaser to nominate a price for its gas sold under the Lease 2 contract. If it did that, the purchaser could not make a nomination request with respect to its gas sold under the Lease 1 and 3 contracts, since E is a non-signatory co-owner of those leases.

[256] While abandonment with respect to one working interest owner's gas may cause some operational difficulties, the Commission does not believe these difficulties to be insuperable. Split-stream sales are common. Thus, it should be possible for a working interest owner to sell its gas to a different purchaser than the other working interest owners sell to. In addition, producers can adjust production from wells. Therefore, if a working interest owner fails to find a new purchaser for gas released under the good faith negotiation rule, it should be possible to make the necessary adjustments in production to account for this.

If A, as the operator of Lease 1, makes a nomination request with respect to old gas sold from that lease, it must make the request both with respect to its gas and to that of the non-signatory co-owners D and E. The purchaser may then request A to nominate a new price for A, D, and E's gas sold under the Lease 1 contract. It also may request A to nominate a new price for A, B, D, and F's gas sold under the Lease 2 contract since A is the operator of that lease. The purchaser may not make nomination requests with respect to any other gas sold under the Lease 1 and 2 contracts, since the remaining gas is owned by signatory co-owners not covered by A's original nomination request.[257] Finally, even though A and E are non-signatory co-owners of Lease 3, the purchaser may not request that A nominate a new price for any gas sold under the Lease 3 contract since A is neither the operator nor a signatory co-owner of that lease.[258] Likewise, the purchasers may not request that D nominate a new price for any gas sold under the Lease 3 contract since D was a non-signatory party to the Lease 1 contract nominated by A.

One applicant[259] requests that the Commission describe the operation of the good faith negotiation rule with respect to natural gas processing plants. It states that typically a number of producers sell gas to a procesor under percentage of proceeds contracts and the processor then sells the gas to a pipeline under a separate contract. The applicant asks specifically (1) whether the processor is a first seller that can initiate good faith negotiation and (2) whether the processor's nomination request would trigger a right by the pipeline in step 2 to bring to the

[257] This is true even though the signatory co-owner of Lease 2 is E, one of non-signatory co-owners in Lease 1.

[258] If A were a signatory co-owner of Lease 3, the purchaser could request that A nominate a price for its gas covered by the Lease 3 contract.

[259] Samson at 8-7.

bargaining table all its contracts with the behind-the-plant producers which contain some old gas.

A natural gas processor selling gas under the circumstances described is a first seller of natural gas.[260] Accordingly, it is entitled to request under the good faith negotiation rule that the pipeline nominate a new price for any old gas sold under its contract with the pipeline. The purchaser may in step 2 request that the processor nominate a new price for any gas sold under the contract covered by the processor's request and any other contract with the processor containing old gas. This includes new gas which the processor may buy from a behind-the-plant producer in a percentage of proceeds contract covering only new gas, so long as there is old gas in the processor's contract with the pipeline. However, the pipeline may not make a nomination request with respect to any gas sold by the behind-the-plant producers directly to the pipeline under separate contracts. The pipeline may only reach gas sold under contracts with the person who makes the step 1 request.

The behind-the-plant producers selling to the processor under percentage of proceeds contracts are in a position somewhat analogous to that of non-signatory working interest owners. They may not make a nomination request directly to the pipeline since they have no contract with the pipeline. In addition, they cannot initiate good faith negotiations with the processor, since they lack contractual authority to obtain a higher price from the processor. Their contracts permit them to collect only a particular percentage of what the processor collects from the pipeline. Thus, only the processor can initiate good faith negotiation with respect to the behind-the-plant producers' gas sold to the processor in a percentage of proceeds contract. The behind-the-plant producers will receive from the processor the agreed-upon percentage of

[260] NGPA section 2(21). 15 U.S.C. § 3301(21) (1982). *See also* 18 C.F.R. § 270.202(h) (1986).

whatever price the processor obtains from the pipeline for the relevant gas under the good faith negotiation rule or through voluntary negotiations.

A producer who sells directly to the pipeline but nevertheless has its gas processed in the natural gas processing plant would, of course, be in an entirely different position. Its rights would be more analogous to those of a signatory working interest owner. It could initiate good faith negotiations with the pipeline, and its rights would be unaffected by any good faith negotiation conducted by the processor with respect to its contract with the pipeline.

Finally, two applicants[261] ask that the Commission clarify the operation of the good faith negotiation rule with respect to advance prepayment contracts. Pursuant to the advance payment program, which was terminated in 1975,[262] the Commission permitted pipelines to enter into advance payment agreements with producers. Under such agreements the pipeline would make an advance payment to the producer for use in exploring for gas on specified acreage. The agreement generally dedicated to the pipeline all gas produced from the acreage and provided for repayment of the advance payment. Once gas was discovered, separate sales contracts were entered into between the producer and purchaser. The applicants request that the Commission clarify that where there are outstanding advance payments when gas is released under the good faith negotiation rule, the producer must repay those amounts. The applicant also states that some gas dedicated to a purchaser under an advance payments contract may have subsequently qualified for NGPA incentive prices and thereby become "new" gas. The applicant requests that the Commission nevertheless treat that gas as old gas for purposes of the good faith negotiation rule,

[261] ANR and CIG at 10-11.

[262] 54 FPC 3046 (1975).

apparently to ensure that purchasers may seek the renegotiation of that gas if the producer initiates good faith negotiation with the purchaser.

The Commission first observes that virtually all advance payments have already been repaid due to the deadlines for repayment the Commission established when it prohibited parties from entering into further advance payment agreements after December 31, 1975. This fact is reflected in current rate filings which show little or no advance payments in rate base. In any event, nothing in Order No. 451 negates or supersedes the requirements in the Commission's various orders concerning the advance payment program that these payments be repaid.[263] Such requirements remain applicable regardless of whether gas is released under the good faith negotiation rule.

Finally, the Commission sees no reason to treat gas dedicated to a purchaser under an advance payment agreement differently from any other gas. To the extent such gas has qualified for NGPA incentive or deregulated prices, it is subject to renegotiation under the good faith negotiation rule to the same extent as any other similar gas.

G. *Right of First Refusal.* In Order No. 451, the Commission provided that, whenever any gas previously sold to a pipeline which has not accepted Order No. 436 is abandoned under this rule, the producer must give that pipeline's firm sales customers a right of first refusal before selling released jurisdictional gas to anyone else. If the producer packages the jurisdictional gas with other gas, the producer must give the firm sales customers a right of first refusal with respect to the entire package. The procedures established by Order No. 451 governing the right of first refusal generally track those governing the right of first refusal which NGPA section 315(b)

[263] FPC Order Nos. 410, 499, and Order Terminating Advance Payment Program, 54 FPC 3046 (1975).

requires sellers to give to existing purchasers of certain gas removed from the Commission's NGA jurisdiction.

In granting a non-Order No. 436 pipeline's firm sales customers a right of first refusal, the Commission observed that those customers may have relied on the pipeline's continued access to low-cost old gas pursuant to the producer's NGA service obligation. The Commission stated that the right of first refusal should enable the firm sales customers to purchase gas released under Order No. 451 at a price approximately equal to or less than the pipeline's WACOG. Thus, the firm sales customers' access to an adequate supply of gas at reasonable cost is protected.

Rehearing Requests. Producers and some large end-users request that the Commission eliminate the right of first refusal given firm sales customers of non-Order No. 436 pipelines. The producer applicants'[264] primary contention is that the right makes difficult the marketing of their gas, since third parties are reluctant to bid for gas when the firm sales customers can take away any favorable deal they obtain. Producers and large end-users[265] also claim that the right unfairly discriminates against new customers and interruptible customers of the pipeline by giving the firm sales customers a preferential right to the gas.

Pipelines, distributors and consumer representatives generally seek expansion of the right of first refusal. Pipelines and some public service commissions from consuming States[266] request that the Commission grant pipelines a right of first refusal superior to their customers'. These applicants state that such a right would recognize

[264] Indicated Producers at 17.

[265] PGC at 4.

[266] ANR and CIG at 14; Arkla at 16; Florida Gas at 23; Tennessee at 22; Northwest Central at 47; California PUC at 29; N.Y. PSC at 16: Kentucky PSC at 3.

the existing contractual commitment of the gas to the pipeline and the pipeline's reliance on that commitment to provide it adequate supplies to serve its customers. At the same time, however, producers could still obtain a market price for the gas. A right of first refusal for pipelines would also better protect the rights of all their customers, since all of them benefit from the pipeline's exercise of its right, whereas only particular firm sales customers benefit from the exercise of the right of first refusal as provided by Order No. 451. Also, a pipeline's right of first refusal allegedly would discourage producers from rejecting the pipeline's price nomination, and then arranging a short-term sale of the gas to a third party at a price lower than that offered by the pipeline, solely for the purpose of permitting it to abandon its service obligation to the pipeline. Some applicants, believing that the existing purchaser can only nominate a price change and not a change in other terms of the contract, state that a right of first refusal for pipelines would also give them an opportunity to obtain gas under the more favorable non-price terms generally offered today than when the pipelines originally purchased the gas. These include market-out rights.

Pipelines, distributors, and consumer representatives also request that the Commission extend the right of first refusal to the firm sales customers of Order No. 436, as well as non-Order No. 436, pipelines.[267] They state that the Commission's rationale for according that right to the customers of non-Order No. 436 pipelines applies equally to the customers of Order No. 436 pipelines. Both sets of customers relied on their pipeline's continued access to the old gas dedicated to it as assuring access to an ade-

[267] Missouri PSC at 9; PG&E at 6; Minnesota DPS at 8; NDG at 15; Cal. PUC at 29; NI-Gas at 21; SoCal at 7; El Paso at 11; INGAA at 17; Missouri PSC at 8; KP&L *et al.* at 29; ANR and CIG at 16; Arkla at 17; AGD at 16; Northwest Central at 52; AGA at 38; APGA at 61.

quate supply of gas at reasonable prices. The applicants disagree with the Commission's contention that the customers of an Order No. 436 pipeline have less need for the right of first refusal since they "could purchase gas from any producer connected to that pipeline and have the gas transported to them."[268] The applicants state that, unlike the Order No. 451 right of first refusal, Order No. 436 does not give firm sales customers any right to purchase gas from producers connected to the pipeline, but only transportation authority for the pipeline. In fact, one applicant contends that the customers of the Order No. 436 pipeline may have a greater need for the right of first refusal since the pipeline may have less ability to nominate a high enough price because its system supply sales will be under such intense competitive pressure from off-system spot gas. Finally, the applicants state that a right of first refusal is a valuable right, since it allows the customer to avoid the time and expense of finding a seller and negotiating from scratch an agreement with it. Rather, the purchaser can exercise the right of first refusal and be relatively confident that it is purchasing the gas at the best available market price. Applicants state that it is unfair to grant such a valuable commercial right to some firm sales customers and not others solely on the basis of whether their pipeline has accepted Order No. 436.

Order No. 451 provides that if several firm sales customers accept a third party offer, the producer has discretion to determine to which it will sell. Some pipelines, distributors, and consumer representatives[269] contend that this right improperly allows the producer to discriminate among the customers. They state a producer will likely choose to sell to large firm customers instead of smaller customers. The larger customers with greater

[268] 51 Fed. Reg. at 22,207.

[269] APGA at 61-62; AGD at 11-12; Missouri PSC at 9; MPC/NASUCA at 23; Arkla at 19-21.

need for gas are a more desirable market. In addition, if the producer is a pipeline affiliate, it may sell to fuel-switchable customers, rather than the pipelines' firm sales customers who must buy the affiliated pipeline's system supply in any event. One applicant[270] proposes that the Commission provide that full requirements firm sales customers shall have priority over all other firm sales customers in the exercise of the right of first refusal.

Commission Response. The Commission rejects proposals by producers and large end-users to eliminate the right of first refusal. The Commission continues to believe that giving firm sales customers of non-Order No. 436 pipelines that right is desirable in order to protect their continued access to adequate supplies at reasonable costs since they relied on the pipeline's continued access to such gas under its service obligation. Thus, the right of first refusal supports the Commission's decision to grant abandonment to producers under section 7(b) of the NGA, if the producer and pipeline fail to reach agreement under the good faith negotiation procedures.

The Commission does not believe that the obligation to give firm sales customers this right unduly burdens producers. NGPA section 315(b) already requires that producers grant a similar right to the existing purchaser for certain gas removed from the Commission's NGA jurisdiction. The producer's obligations under section 315(b) have not had a significant adverse effect on producers' ability to market their gas by discouraging third parties from bidding for the gas. There appears no reason why the right of first refusal obligation imposed by Order No. 451 should have a more significant adverse effect. It is of course true, as pointed out by Indicated Producers,[271] that many pipelines have large numbers of firm sales customers and therefore a producer may, after

[270] Arkla at 20.

[271] at 18.

arranging a sale to a third party, have to give the right of first refusal to many persons. The Commission recognizes that this may place some administrative burdens on the producer. However, the Commission believes that these burdens are mitigated by the requirement that pipelines provide producers with the names and addresses of their firm sales customers. The Commission believes that any burdens on producers from granting the right of first refusal are outweighed by the need to provide firm sales customers the protection afforded by that right.[272] Finally, the Commission rejects the contention that granting the right to firm sales customers unfairly discriminates against new and interruptible customers. As explained above, the firm sales customers may have relied on the pipeline's continued access to old gas pursuant to the producer's NGA service obligation as insuring their access to an adequate supply of gas at reasonable prices. An interruptible customer could not similarly rely on access to the pipeline's old gas since, as an interruptible customer, it was subject to loss of that gas in any event. A new customer obviously never relied on the pipeline's access to the old gas.[273]

[272] Indicated Producers (at 18) also contends that the right of first refusal granted by Order No. 451 may act as a disincentive for pipelines to accept Order No. 436. It states that the present good faith negotiation procedures may "allow non-Order No. 436 transporters and their customers to lock-up old gas while selectively discontinuing the purchase of high-cost supplies." The Commission rejects this argument. Obviously, there are a vast number of factors a pipeline must consider in determining whether it is advantageous for it to become an Order No. 436 pipeline. This one-sentence assertion, unsupported by any analysis, does not convince the Commission that the right of first refusal under Order No. 451 provides an advantage to pipelines rendering them less likely to accept Order No. 436.

[273] The Commission also rejects PGC's alternative proposal for protecting firm sales customers' access to low-cost old gas without giving them a right of first refusal (at 4-7). That proposal is to give the firm sales customers exclusive rights to purchase the gas

The Commission now turns to the contentions of various applicants that the right of first refusal should be modified. First, the Commission rejects the proposal that pipelines be granted a right of first refusal. Pipelines already have an adequate opportunity to negotiate for continued purchases of the old gas under the good faith negotiation rule, a right that their firm sales customers lack. Furthermore, granting a pipeline a right of first refusal would remove any incentive it has to negotiate in good faith under the good faith negotiation rule. Since that rule requires that in the absence of agreement producers continue sales to the existing purchaser at the existing price until the producer finds another purchaser, a pipeline with a right of first refusal would have every incentive to nominate an unreasonably low price, comfortable in the fact that if the price was rejected and the producer found another purchaser willing to pay a higher market price the pipeline could then exercise its right of first refusal. Thus, as a practical matter, granting pipelines a right of first refusal could largely sabotage the proper operation of the good faith negotiation rule. Furthermore, it is not necessary, as argued by some applicants, to grant this right to pipelines in order to give them an opportunity to obtain relief from unfavorable non-price terms in the existing contracts. As stated in the previous section, the pipeline may in its price nomination propose changes in any other term of the contract.

The Commission also rejects the proposal that the right of first refusal be extended to the firm sales customers of an Order No. 436 pipelines. Those customers do not have

for thirty days after its release. However, thereafter the producer would be free to sell to anyone else unencumbered by any right of first refusal. The Commission does not believe this proposal gives adequate protection to the firm sales customers. A producer could simply refuse to negotiate with them and then sell to another purchaser after 30 days.

the same need for the right as the customers of a non-Order No. 436 pipeline. Order No. 451 provides the customers of a non-Order No. 436 pipeline only limited transportation rights over that pipeline. They can obtain transportation only of gas formerly sold to the pipeline and released under the good faith negotiation rule. The customers of an Order No. 436 pipeline, by contrast, have much broader transportation rights. They can obtain transportation of any gas whether or not formerly sold to the pipeline or released under the good faith negotiation rule. Thus, there is less need to protect their access to the released old gas formerly sold to the pipeline.

Even assuming applicants are correct that the cost of an Order No. 436 pipeline's system supply may be more likely to increases than that of a non-Order No. 436 pipeline, the customers of the Order No. 436 pipeline are adequately protected by their ability to purchase non-system supply gas and obtain transportation. Finally, while, as some applicants point out, the right of first refusal may be a valuable commercial right, the Commission believes it should grant that right only to those with a need for it. As already discussed, the firm sales customers of an Order No. 436 pipeline do not need that right.

The Commission also refuses to alter the provision that, when more than one firm sales customer exercises its right of first refusal, the producer may in its discretion determine to which it will sell. The Commission is not convinced that the discrimination alleged by various applicants will occur. Any attempt to establish a priority system governing the producer's selection of the firm sales customers to which it will sell would complicate the rule and place additional administrative burdens on the parties. Therefore, the Commission is reluctant to establish such a system.

One applicant[274] requests that the Commission clarify that gas not released under the good faith negotiation

[274] Arkla at 22-23.

rule, and thus not subject to the right of first refusal, may not be included in the agreement with a third party offered to the firm sales customers for their right of first refusal. The applicant is concerned that otherwise a producer and third party might include a large amount of unreleased gas in the third party agreement in order to preclude acceptance by most firm sales customers who have no need for so much gas. The Commission agrees that the offer to the third party must include only gas released under the good faith negotiation rule in order to avoid circumvention in the manner suggested by the applicant. In Order No. 451, the Commission did provide that where the offer to the third party encompasses "non-jurisdictional, as well as jurisdictional gas, the right of first refusal will apply to the entire offer." The non-jurisdictional gas referred to was intended to include only non-jurisdictional gas released under the good faith negotiation rule.

The same applicant also requests that the Commission clarify that where a pipeline and a local distribution company are divisions of the same corporation and no sales contract exists between the two, the local distribution company should nevertheless be considered a firm sales customer of the pipeline division for purposes of the right of first refusal. The Commission agrees. If the two were separate but affiliated corporations, the local distribution company would fall within the definition of firm sales customer. There appears no reason to distinguish between the two situations.

Another applicant[275] requests that the Commission clarify whether a firm transportation customer of the pipeline has a right of first refusal. It does not. That right is limited to firm *sales* customers, those being the customers who relied on the pipeline's access to old gas as ensuring their access to adequate supplies at reasonable cost.

[275] ANR and CIG at 28.

One other applicant[276] requests that the Commission lengthen the 20-day deadline for firm sales customers to accept or reject the third party offer. The applicant contends that the 20-day period provides no opportunity to bargain with the producer. There is no need to provide such opportunity since under the regulations governing the right of first refusal the customer must either accept or reject the offer. Any counteroffer constitutes a rejection. The 20-day response period is the same period provided under the regulations governing the section 315(b) right of first refusal. The Commission is not aware that 20 days has proven too short under section 315(b).

Finally, the Commission addresses the relationship between the existing purchaser's section 315(b) bona fide offer and right of first refusal rights and their customers' Order No. 451 right of first refusal. Section 315(b) requires that when a contract for the sale of NGPA section 102(c), 103(c), or 107(c)(1)-(4) gas which was subject to the Commission's NGA jurisdiction on the day before enactment of the NGPA expires or is terminated, the seller must give the existing purchaser a bona fide offer and right of first refusal before selling to a third party. One applicant[277] claims that the Commission has not made any provision in the good faith negotiation rule for the original purchaser's section 315(b) rights.

It is true that on occasion the existing purchaser may have rights under section 315(b) after release of gas under the good faith negotiation rule. Such rights would, of course, arise only with respect to non-jurisdictional sections 102(c), 103(c), and 107(c)(1)-(4) gas released by the pipeline since that is the only gas to which section 315(b) applies.[278] Where such rights do arise in the context of the good faith negotiation rule, the Commission believes that the producer's nomination of a price for the relevant gas in response to the purchaser's step 2 request constitutes the bona fide offer required by section 315(b), and no additional bona fide offer need be given. However, the producer must still give the existing purchaser its right of first refusal with respect to released section 102(c), 103(c), and 107(c)(1)-(4) gas dedicated to interstate commerce on the day before enactment of the NGPA pursuant to the procedures set forth at § 277.206 of the Commission's regulations. There is, however, no overlap between the section 315(b) and Order No. 451 rights of first refusal. According to the usual practice, the producer must offer only the gas covered by section 315(b) to a third party and present any offer substantially accepted in principle to the original purchaser. In order to comply with § 277.206 the producer must either (1) sell the gas to the third party under the terms of an offer rejected by the original purchaser or (2) sell the gas to the original purchaser.[279] Thus, the gas covered by section 315(b) will never be available for packaging with released jurisdictional gas in a third party offer covered by the Order No. 451 right of first refusal.

[276] APGA at 63.

[277] APGA at 59.

[278] The fact the purchaser terminated the contract would not deprive it of its section 315(b) rights. *See* Order No. 95-A, FERC Stats. and Regs. ¶ 30,690 (1986) at 30,164-65.

H. *Blanket Sales Certification*

In Order No. 451, the Commission promulgated a new regulation, 18 C.F.R. § 157.301, granting producers blanket authorization to sell gas abandoned under the good faith negotiation rule for resale in interstate commerce. Section 157.301 also provides pre-granted abandonment authorization to discontinue sales of gas upon termination of a contract of sale, requires annual reports of sales initiated under the blanket certificate during the preceeding calendar year, and waives rate filling requirements for sales under the blanket certificate.

[279] § 277.204(b).

In their request for rehearing ANR Pipeline Company (ANR) and Colorado Interstate Gas Company (CIG) state that the order appears to require that the abandoned gas *must* be sold for resale in interstate commerce.[280] ANR and CIG assert that such a limitation on the sale of abandoned gas is desirable to assure continued gas supply to the interstate market, and request a clarification from the Commission that the sales of the abandoned gas are so limited. Florida Gas Transmission Company and Transwestern Pipeline Company, on the other hand, argue that the Commission lacks jurisdiction over sales of abandoned gas, except for certain gas from the Outer Continental Shelf (OCS), and seek a Commission declaration that the blanket sales authority granted under the new § 157.301 is only required for such sales, and that abandoned gas can otherwise be sold free from Commission regulation.[281]

None of these applicants correctly stated the effect of abandonment under the good faith negotiation rule. When a producer abandons sales of gas under the rule, the producer is free to sell the abandoned gas to whomever it chooses—whether to an end-user, an interstate pipeline, an intrastate pipeline, or a marketer. A limitation on the sale of abandoned gas to the interstate market, as requested by ANR and CIG, would not be good policy. The Commission sees no need to erect a regulatory barrier to movement of the abandoned gas in response to market forces, or to perpetuate the dichotomy between the interstate and intrastate gas markets that Congress sought to eliminate in passing the NGPA.

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[280] ANR and CIG at 27.

[281] Florida Gas at 12-15; Transwestern at 6-10. Florida Gas and Transwestern's position on this issue is not entirely clear. They may be arguing that the sale of abandoned gas requires certificate authority only if the sale is for resale in interstate commerce, *i.e.*, a jurisdictional sale under the NGA.

Under Section 7(c) of the Natural Gas Act, sales of natural gas for resale in interstate commerce require certificate authority from the Commission. Although section 601(a) of the NGPA removed certain gas from the Commission's NGA jurisdiction, some of which may be released under the good faith negotiation rule, the only released gas which needs and therefore receives abandonment authority under the rule is the gas which has not been removed from the Commission's NGA jurisdiction. Therefore, since the gas which is abandoned under the good faith negotiation rule has not been removed from the Commission's NGA jurisdiction, the sale of such gas for resale in interstate commerce requires NGA certificate authority. The new § 157.301 grants that authority. No certificate authority is needed for any other sales of the abandoned gas or for sales of gas released under the rule which has been removed from the Commission's NGA jurisdiction.

Tennessee Gas Pipeline Company asks if the blanket certificate authority granted by § 157.301 is limited to the first sale of the abandoned gas, or if is it applicable to all subsequent sales of such gas.[282] The blanket certificate authority under § 157.301 applies to any sale of the abandoned gas by the party who received abandonment authority under the good faith negotiation rule. Thus, if abandoned gas has been sold under the authority of § 157.301 and such sales have then been abandoned under § 157.301(b) (pre-granted abandonment), subsequent sales from the same wells or leases may also be made under § 157.301. However, the sales authority of § 157.301 is available only to the first seller (or its successor) who has abandoned sales of the gas under the good faith negotiation rule. A reseller who purchases such gas must have its own certificate authority to sell the gas for resale in interstate commerce.

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[282] Tennessee at 34.

Indicated Producers request the Commission to extend the due date for reports of sales made under the authority of the blanket certificate from March 1 to June 1, asserting that data relating to sales during the latter months of the preceding calendar year will frequently not be available from wells operated by other parties and from gas processing plants until several months after the end of the year.[283] The Commission will extend the due date of such reports until April 1 because it appears that some additional time is warranted. If relevant data is not available to a producer until after April 1, an amended report should be filed.

Kansas Power and Light Company *et al.* (KP&L et al.) argue that the Commission erred by failing to provide a hearing before granting blanket sales authorization under § 157.301 because Section 7(c) of the NGA requires that a hearing be held before issuance of a certificate of public convenience and necessity.[284] The Commission believes that the opportunities afforded in this proceeding for comments, reply comments, public hearing, and requests for rehearing satisfy the hearing requirement of Section 7(c).[285] The Commission has already found that sale of the abandoned gas for resale in interstate commerce by a producer already authorized to sell the gas to an existing interstate purchaser is in the public interest. A requirement of additional hearings on individual applications for authority to sell such abandoned gas would be unnecessary and impose a detrimental regulatory barrier to the continued movement of the gas in the interstate market, especially since producers have the option to sell the abandoned gas elsewhere without a certificate.

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283 Indicated Producers at 32.

284 KP&L et al. at 18.

285 *See* Area Rates for the Appalachian and Illinois Basin Areas, 44 FPC 1112 at 1117-1120 and 1132 (1970).

I. *Transportation Authority*

In the final rule the Commission noted the concern of many commenters that pipelines may release gas under the good faith negotiation rule but then refuse to provide transportation to another purchaser. Since a pipeline which can refuse to transport the released gas to an alternative market is in a position to extract unreasonable concessions from the producer to the detriment of the market generally, or even to refuse to negotiate at all, the Commission acted pursuant to its NGA section 5(a) and other statutory authority to prevent such forms of undue discrimination. Accordingly, the Commission provided for the availability of transportation services by pipelines not subject to the open-access provisions of Order No. 436. The transportation service was authorized to any of the releasing pipeline's existing customers (whether firm or interruptible, sales or transportation customers) and to any interconnecting pipeline. This transportation requirement was a condition on the right of the existing pipeline purchaser to terminate purchases of gas from a first seller under the rule, and on the pipeline's right to nominate contracts or volumes of gas other than those nominated by the producer.[286] The limited transportation requirement assures that the pipeline's existing customers, especially firm sales customers, have continuing access to their original gas supply, and that released gas will find a ready market. The Commission noted that the transportation authorization would ensure that the released gas under the new ceiling price would be brought to market, would serve the public convenience and necessity under NGA section 7, prevent undue discrimination in violation of NGA section 5(a), and would thereby lower prices for all consumers and ensure the just and reasonable operation of the new ceiling price.[287]

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286 *See* 18 C.F.R. § 270.201(h).

287 The Commission found that "failure to condition [avoidance of] the new ceiling price with a transportation provision would

In order to avoid regulatory cost to the pipeline, or unnecessary delay in achieving market-responsive benefits to consumers, the Commission provided a blanket transportation certificate under section 7(c) of the NGA to jurisdictional pipelines not already transporting under Order No. 436.[288] The Commission stated that refusals to transport would be scrutinized carefully under the Natural Gas Act and other applicable law.

Requests for Rehearing. Several pipelines and others have challenged the grant of transportation authority and the transportation requirement in the rule, alleging that these provisions are outside the scope of the Commission's authority under the Natural Gas Act and NGPA.[289] Such applicants characterize the transportation provisions in the rule as an unlawful imposition of common carrier status on unwilling pipelines. Tennessee and KN Energy both devote several pages of their rehearing

cause the new ceiling price to be unjust and unreasonable under section 5(a) of the NGA," insofar as the gas would not be brought to market. 51 Fed. Reg. 22,213 (June 18, 1986). This has been apparently misconstrued by some petitioners as an indication that the new ceiling price is somehow not within the zone of reasonableness absent the transportation requirement. This issue is discussed *infra.*

[288] *See* Order No. 451, Appendix B, for pipelines already indicating intent to provide non-discriminatory transportation at the date of issuance. 51 Fed. Reg. 22,222-23 (June 18, 1986). Pipelines transporting gas under the blanket certificate would not become subject to the open-access requirements of Order No. 436 (18 C.F.R. § 284.8(b) and 284.9(b)) solely by reason of such transportation. Moreover, when requested by the first seller to provide transportation, intermediary pipelines not subject to Order No. 436 open-access requirements, and upstream from the pipeline releasing gas under the rule, may use the separate transportation certificate under section 7(c) of the NGA provided by new § 284.226.

[289] *See, e.g.*, APGA at 63-68; AGD at 12; and ANR and CIG at 5-6; Florida Gas at 6-12; Texas Eastern at 21-22; MPC/NASUCA at 33-34.

applications to a discussion of the legislative history of the Natural Gas Act and the specific language of section 602(b)(2) of the NGPA, to support the proposition that Congress provided that "[n]o person shall be subject to regulation as a common carrier . . . by reason of any transportation . . . authorized by the Commission under section 311(a) of this Act." 15 U.S.C. § 3371(a) (1982).[290] The Commission rejects the argument that Order No. 451 subjects transporters to common carrier regulation. Rather, the transportation requirement is a case-specific-requirement arising out of the particular circumstances of individual pipelines, their certificate obligations, and their duty not to discriminate unduly. Some of the applicants also argue that the transportation authority and new ceiling price are so "of one piece" that if the transportation provisions are held to be legally flawed or to require modification, the new ceiling price would become unjust and unreasonable.[291]

Producers and large industrial consumers of natural gas consider the transportation requirements fully supportable under applicable statutes and Commission precedents, but believe the transportation authorization is too narrow in scope.[292] These applicants urge that the transportation authority be broadened to include intermediate upstream or downstream pipelines if the rule is to have the optimum desired effect of increasing market responsiveness in the natural gas industry.[293] Others suggest that intrastate pipeline transportation should be included,[294] or that the authorized transportation should cover Order No. 436 (open access) pipelines to ensure

[290] Tennessee at 25-28; KN at 20-25.

[291] *See e.g.*, KP&L *et al.* at 9-10; Southern Natural at 12.

[292] Indicated Producers, PGC.

[293] *See, e.g.*, Indicated Producers at 18-24, PGC at 7-9.

[294] IPAA at 5.

that transportation of released gas to new purchasers will be adequate.[295]

Commission Response. We disagree with the applicants alleging that the transportation authority promulgated in Order No. 451 is beyond the Commission's statutory authority. The transportation obligation placed on a pipeline in certain circumstances is supported by statute and case law, as discussed *infra.*

The statutory provisions relevant to the Order No. 451 transportation requirement include NGPA sections 104, 106, and 501,[296] and Natural Gas Act sections 5, 7, and 16.[297] In particular, section 5(a) and its interaction with these other provisions is the central focus of our statutory authority here. Section 5(a) provides that when the Commission finds that

> any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order . . . .

15 U.S.C. § 717d(a) (1982). Certain applicants simply ignore these relevant statutory provisions and instead focus on NGPA section 311.[298] No "common carrier" status has been mandated that would contravene NGPA

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[295] Amoco at 3.

[296] 15 U.S.C. §§ 3314, 3316, and 3411 (1982).

[297] 15 U.S.C. §§ 717d, 717f, and 717o (1982).

[298] They state that while section 311(a)(1) of the NGPA permits the Commission to authorize interstate pipelines to provide interstate transportation for local distribution companies and intrastate pipelines, section 602(b)(2) of the NGPA provides that no person shall be subject to regulation as a common carrier by reason of any section 311(a) transportation. However, the transportation policy of Order No. 451 is not predicated on NGPA section 311(a).

section 602(b)(2). Rather, the statutory authority for the essential transportation requirement is found in sections 5(a) and 7 of the Natural Gas Act (NGA), and the general grants of authority in the NGA and NGPA, namely, NGA section 16 and NGPA section 501(a),[299] in conjunction with NGPA sections 104(b)(2) and 106(c).

Some applicants challenge the Commission's power to condition rates under NGPA sections 104(b)(2) and 106(c) and NGA sections 5(a) and 7[300]. As previously emphasized, the Commission's authority here derives from a harmonious interrelationship of NGA section 5 with sections 7 and 16, not from any of them in isolation.

Other applicants acknowledge that the Commission has such authority that may be used to effect access to gas, but argue that the Commission overreached its authority in this instance.[301] These applicants contend that it con-

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[299] Section 16 of the NGA provides that "[t]he Commission shall have power to perform any and all acts, and to prescribe, issue, make, amend, and rescind such orders, rules, and regulations as it may find necessary or appropriate to carry out the provisions of this act." 15 U.S.C. § 717o (1982). Section 501(a) of the NGPA provides that "[t]he Commission . . . is authorized to perform any and all acts (including any appropriate enforcement activity), and to prescribe, issue, amend, and rescind such rules and orders as it may find necessary or appropriate to carry out its functions under this Act." 15 U.S.C. § 3411(a) (1982).

[300] *See, e.g.,* APGA at 64 n.2, ("section 5(a) contains *no express authority to order transportation*") quoting Order No. 436, FERC Stats. & Regs. ¶ 30,665, p. 31,500 (1985) (emphasis in the original); and APGA at 67 ("the Commission cites its conditioning power under NGPA sections 104(b) and 106(c) as statutory authority authorizing it to impose a mandatory transportation obligation . . . [but] cites no legislative history or case law to support this assertion . . . .")

[301] *See e.g.,* Northern Natural at 25 ("To the extent conditions may be attached to an exercise of this authority at all, these conditions may extend only to the regulated entities that are *changing* the rates" (emphasis in original)). Yet, the pipeline ceasing purchase of high-cost gas (or any gas for that matter) under Order

stitutes an abuse of the Commission's discretion to preserve the pipeline purchaser's transportation obligation as part of the good faith negotiation procedures. This is simply a plea to substitute these applicants' judgment of what requirements are in the public interest for the Commission's. This suggestion is rejected because the Commission finds the public interest will be served by the transportation obligation—by the protection of the existing firm customers and the continuance of the flow of gas to the market—and this is integral to the functioning of the rule.[302] The Commission therefore confirms that the rule, *as promulgated*, benefits all participants in the process—consumers, transmission and distribution companies, and producers—and declines to remove the important transportation obligation from releasing pipelines.

KN and others appear to misapprehend the interrelationship between the Commission's authority to establish just and reasonable rates for the transportation and sale of natural gas under NGA section 5, the new just and reasonable ceiling price, and the transportation requirement. Certain language in the order may be the source of the misapprehension. Accordingly, the Commission

No. 451 is effectively changing its rates as well. INGAA at 13-14 takes a slightly different tack. While acknowledging the Commission's conditioning power, INGAA objects to the transportation provision. ("While INGAA disagrees with the assertion by the Commission of an authority to require pipelines to transport gas, we do not doubt generally that the Commission's conditioning authority can lawfully affect the access of deregulated gas into interstate commerce," *citing* FPC v. Transcontinental Gas Corp. 365 U.S. 1 (1961). *See also* Tennessee at 28-30. Tennessee acknowledges that where "the purchaser will have been granted a valuable right . . . the condition may be lawfully attached." Tennessee at 30.

[302] Because transportation is being required pursuant to NGA sections 5, 7, and 16 the rule is changed by deleting the phrase "deemed to agree" and conforming changes are made at §§ 270.201 (h) and 284.225 (a) of the regulations.

would note that its statement that the "failure to condition the new ceiling price with a transportation provision would cause the new ceiling price to be unjust and unreasonable under section 5(a) of the NGA,"[303] merely reflects its conclusion that failure to condition avoidance of the new just and reasonable ceiling price on the availability of transportation would cause the new ceiling price to become unjust and unreasonable under section 5(a) of the NGA, insofar as the gas would not be brought to market, the market-responsive benefits of the rule would not be achieved, and the rights of first refusal granted to firm sales customers would be frustrated in operation. Thus, the focus of the transportation provision is not on price *qua* price, but on the essential need to get the gas to market.

There was, in short, no intention to imply that the new just and reasonable ceiling price is outside the "zone of reasonableness" absent transportation. Rather, the price bid for the section 104 or 106 gas, whether up to the new ceiling or below it, will elicit neither the supply nor price response which is the underlying purpose of the rule, if the gas cannot be brought to market. In that case, the new "just and reasonable" ceiling price would be the product of a meaningless exercise, since lacking the ancillary but integral transportation the gas would have much greater difficulty reaching the market, and the benefits of the rule would be commensurately delayed or curtailed. Furthermore, the significant role of the right of first refusal in protecting firm sales customers and consumers would be frustrated directly and completely without the availability of transportation. In the absence of assured transportation, the right of first refusal would be a hollow gesture, because it could not operate without a separate, contestable transportation authorization. Consequently, the Commission would be seriously constrained in its analysis of the just and rea-

[303] 51 Fed. Reg. 22,213 (June 18, 1986).

sonable result without the availability of transportation.[304]

As one court has stated, "'just and reasonable' is merely a term of art for the public interest . . . ."[305] No one should misapprehend any language in Order No. 451 as a statement that the new alternative ceiling price under NGPA sections 104 and 106 is not prescribed in the public interest, and just and reasonable as within the reasonable range of replacement costs. However, newly priced gas must be keyed to the availability of transportation, or the market-responsive benefit of the rule would be lost, and the public interest benefits of the new ceiling price also lost. It is in this sense that the new ceiling is only just and reasonable in conjunction with the accompanying transportation provision.

The facilitation of market-responsive pricing undertaken in Order No. 451 by continuation of the transportation requirement for released gas under the Order No. 451 procedures fully comports with NGA and NGPA goals of adequate supply at a reasonable cost. By requiring a pipeline to continue to provide transportation for released volumes, the pipeline is prevented from unduly discriminating against the existing seller and harming competition by denying a producer transportation and

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[304] This distinguishes Order No. 451 from Opinion No. 245 cited by some petitioners in support of recission of the transportation authorization. Felmont Oil Corporation and Essex Offshore, Inc., 33 FERC ¶ 61,333 (1985), *reh'g denied*, 34 FERC ¶ 61,296 (1986), petition for review pending *sub nom.* Consolidated Edison Company of New York, *et al.* v. FERC, D.C. Cir. Nos. 86-1168 *et al.* In Opinion No. 245 the Commission was concerned solely with crafting a proper limited term abandonment so as to protect the rights of all of the several parties in a single abandonment proceeding. Under Order No. 451, however, omission of transportation access would, as discussed in the text, undermine the just and reasonable result.

[305] Pennzoil Co. v. FERC, 645 F.2d 360 at 392 n.27 (5th Cir. 1981).

thereby blocking the benefits of the final rule.[306] The Commission's authority serves as a "first line of defense" against anticompetitive practices.[307]

Nor must the Commission make specific findings for each pipeline; it can exercise its authority under NGA sections 5(a), 7, and 16 generically as it did here.[308] While the seller's side of the wellhead market is workably competitive, considerable evidence suggests that pipeline buyers in the wellhead market have significant market power. Recent studies by EIA[309] and Broadman[310], for example, reach this conclusion.

In the final rule, the Commission is using its section 5(a) authority to require that the blanket transportation authorization established by the rule be utilized by the former pipeline purchaser. This is, in effect, a continuation of the pipeline's existing service obligation to move the gas to market.[311] If a pipeline refuses, without Commission authorization, to *continue to* transport the volumes of gas its facilities were dedicated to transport, the circumstances of this rule, that will be considered an un-

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[306] *Cf.* Richmond Power & Light v. FERC, 574 F.2d 610, 623 (D.C. Cir. 1978) (Even though the Commission has no authority to compel transmission service, a different case is presented when the agency acts to prevent undue discrimination or anticompetitive activities).

[307] *See* Gulf States Utilities Co. v. FPC, 411 U.S. 747, 760 (1973).

[308] *See* Wisconsin Gas Co. v. FERC, 770 F.2d 1144 (D.C. Cir. 1985).

[309] Richard P. O'Neill, James B. Tobin, and Henry Clarius, "Pipeline Mergers and Their Potential Impact on Natural Gas Markets," *Natural Gas Monthly*, Energy Information Administration, February 1986, p. XXVIII.

[310] Harry G. Broadman, "Elements of Market Power in the Natural Gas Pipeline Industry", The Energy Journal, Vol 7, No. 1 (1986), p. 136.

[311] United Gas Pipe Line Co. v. FPC, 385 U.S. 83 (1966); Panhandle Eastern Pipe Line Co. v. FERC, 803 F.2d 726 (D.C. Cir. 1986).

authorized abandonment, separate and apart from the seller's abandonment of the "sale".[312] The pipeline's abandonment must be considered in light of its "obligation, deeply imbedded in the law, to continue service."[313] This is particularly apposite in the context of the good faith negotiation procedures, should the pipeline's existing firm sales customers—those for whose benefit the facilities were certificated and whose rates supported those facilities—exercise their right of first refusal and purchase the released gas. It is also important so that producers will have market access for these certificated gas supplies.

This Order No. 451 transportation requirement then is not "common carriage" as argued by some commenters. Rather, it is a requirement that in particular circumstances the former pipeline purchaser must utilize the blanket transportation authorization granted under the rule, because it is not being relieved of its existing obligation to move the gas, in order to further the Commission's goals under NGA section 5(a) of protecting existing customers, moving gas to market, and achieving the just and reasonable benefits of the rule.

A number of petitioners note the Commission's authority to direct extension or improvement of transportation facilities under NGA section 7(a).[314] Yet Order No. 451 is not grounded on the exercise of NGA section 7(a) authority and thus allegations of exceeding that authority are misplaced. No extension, improvement, or establishment of facilities occurs under Order No. 451. Rather,

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[312] *See, e.g.*, United Gas Pipe Line Co. v. McCombs, 442 U.S. 529 (1979); California v. Southland Royalty Co., 436 U.S. 519 (1978); Sunray Mid-Continent Oil Co. v. FPC, 364 U.S. 137 (1960).

[313] *See* Michigan Consolidated Gas Co. v. FPC, 283 F.2d 204, 214 (D.C. Cir. 1960), *cert. denied*, 364 U.S. 913 (1960).

[314] 15 U.S.C. § 717f(a) (1982). *See e.g.*, Southern Natural at 20-21, *citing Rural Energy Systems, Inc.*, 34 FERC ¶ 61,389 (1986).

existing facilities are likely to be used as they were before, only the business relationships of the parties will have been changed. Accordingly, citations to section 7(a) cases in support of the proposition that the Commission cannot impose transportation obligations are not on point,[315] since under Order No. 451, the Commission is exercising its section 5(a) authority (in conjunction with the other statutory bases discussed herein).

Nor is there any violation of the "able and willing" requirement of NGA section 7(e),[316] as argued by some commenters.[317] If a pipeline elects to bid a lower price than the price which it is obligated to pay under the existing contract and to accept the right to counternominate higher priced old gas (above market levels) in old gas contracts and high-cost gas in multi-vintage contracts for possible reduction, the purchaser signals that it will seek to abandon purchases of that gas if its price terms are not met. If a purchaser is willing and able to purchase and transport gas sold under the producer's certifi-

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[315] *See, e.g.*, Southern Natural at 20-21 *citing* Panhandle Eastern Pipe Line Co. v. FPC, 204 F.2d 675, 679-81 (3rd Cir. 1953); Panhandle Eastern Pipe Line Co., 15 FPC 46, 56-59 (1956), *aff'd sub nom.* Central West Utility Co. v. FPC, 247 F.2d 306, 311 (1957); Consolidated Gas Supply Corp., 28 FERC ¶ 61,350 (1984).

[316] 15 U.S.C. § 717f(e) (1982) ("[A] certificate shall be issued . . . if it is found that the applicant is able and willing properly to do the acts and to perform the service proposed . . . .")

[317] *See, e.g.*, KN at 31 and at 34 *citing* Atlantic Refining Co. v. Public Service Commission of New York, 360 U.S. 378 (1959), FPC v. Texaco, 417 U.S. 380, 394 (1974); Hunt v. FPC 306 F.2d 334, 341 (5th Cir. 1962) *rev'd on other grounds*, 376 U.S. 515 (1964); Northern California Power Agency v. FPC, 514 F.2d 184, 189 (D.C. Cir. 1975). Not only are these cases inapposite from the perspective of the purchaser's abandonment of its purchases, the facilities to be used for the required transportation will be adequate for the service proposed, since they are already being utilized for that purpose. *See* Northern Natural Gas Co., 25 FPC 540, 544 (1961).

cate, (a finding which was made by the Commission in granting the certificate in the first place,) the Commission finds as a matter of law that the purchaser remains "able and willing" to continue transporting gas released under Order No. 451. The pipeline cannot simply refuse to transport the gas and by that act thwart the Commission's exercise of its remedial authority under Sections 5(a) and 16. Nor can the pipeline, by that act, relieve itself of its existing service obligation to transport the gas.

Both the NGA and the NGPA confer general grants of authority to the Commission which have been interpreted broadly by the courts and which support the transportation obligation in the final rule. Under the broad authority granted pursuant to section 501 of the NGPA and section 16 of the Natural Gas Act, the Commission may act to prevent and/or eliminate distortions in the natural gas markets in conjunction with its specific authority under NGPA sections 104(b)(2) and 106(c), and NGA sections 5(a) and 7. Such general grants of authority, of which NGA section 16 and NGPA section 501 are examples, are "not restricted to procedural minutiae, and . . . authorize means of regulation not spelled out in detail, provided the agency's action conforms with the purposes and policies of Congress and does not contravene any terms of the Act.[318] More recently, in *Northern Natural Gas Co. v. FERC*, 785 F.2d 338, 343 (D.C. Cir. 1986), the court held that Congress has granted broad remedial authority in section 16 of the Natural Gas Act to carry out the difficult task of regulating the natural gas industry "under appropriate equitable circumstances" and found it appropriate for the Commission to construe its authority broadly.[319]

[318] Mesa Petroleum Co. v. FPC, 441 F.2d 182, 187 (5th Cir. 1971), *citing* Niagara Mohawk Power Corp. v. FPC, 379 F.2d 158.

[319] *See also* Consolidated Gas Transmission Corp. v. FERC, 771 F.2d 1536, 1550-51 (D.C. Cir. 1985); Public Service Comm'n of the

The statutes discussed herein (NGA sections 5, 7, 16 and NGPA sections 104, 106 and 501) support the Commission's authority, and those applicants that assert there is no statutory basis for an obligation to continue service to bring the gas to market are in error.

Adjustment to Transportation Authorization

After careful consideration of various commenters' requests,[320] the Commission has determined to expand the transportation authorization in the rule to cover upstream, third-party pipelines which may transport the released gas for redelivery into the system of the former pipeline purchaser. The Commission finds that providing a voluntarily assumable blanket transportation authorization for upstream "feeder" pipelines will serve the twin public interest goals of protecting existing firm customers *and* continuing the flow of gas to the market.

The Commission believes upstream pipelines with available capacity will thus be able to utilize the blanket authorization provided without any regulatory delay or impediment, in order to provide essential transportation services to the same extent they had previously.

The Commission does not believe any blanket transportation authorization is required for interconnecting pipelines downstream of the former pipeline purchaser. Under the final rule, the former pipeline purchaser is already required to deliver the released gas to any interconnecting pipeline, which may continue to transport the gas under such transportation authorization as already exists, or which it may obtain in the future. Interconnecting downstream pipelines thus have the right to purchase

State of N.Y. v. FPC, 327 F.2d 893, 897 (D.C. Cir. 1964). (Section 16 of the Natural Gas Act held to provide a basis for the Commission to cope with unforeseen problems, and is not confined to procedural regulations, but is a broad grant of authority.)

[320] *See, e.g.*, Indicated Producers at 22-24; PGC at 7-9.

released gas and have it delivered by the releasing pipeline to the point of interconnection. Transportation beyond that point requires separate authorization.

In any situation where a producer or end-user believes it is being unduly discriminated against by any third-party upstream or downstream pipeline with respect to transportation services, it may request the Commission to intercede and remedy the situation through the filing of a complaint pursuant to 18 C.F.R. § 385.206. The Commission intends the transportation authorization under Order No. 451 to be self-implementing, however, and anticipates that such complaints will be rare.

The Commission also denies requests for expansion of the transportation authority to intrastate pipelines, Canadian producers, domestic producers on a non-releasing pipeline system, or to producers without any old gas.[321] This will in no way be unduly discriminatory or harm such entities. Intrastate producers are in large part beyond this Commission's jurisdiction. In any event, consistent with the goal of eliminating disparities between the interstate and intrastate markets, the rule already provides that gas subject to section 106(b) is eligible for the alternative ceiling price if the seller and purchaser so agree. As for Canadian producers, the Order No. 451 program arises out of the old gas ceiling adjustment provided for in NGPA sections 104 and 106 and does not involve Canadian gas, which is free from any constraints as to price under Title I of the NGPA.[322] In the more market-responsive arena provided by the final rule, Canadian producers as well as domestic producers, whether on non-releasing pipelines or not, will find *less* discrimination and preference as gas sales and purchases become more market-driven. Competitive sellers

[321] *See* Independent Petroleum Ass'n of Canada; Westcoast Transmission Co., Ltd. and Westcoast Resources, Inc.; IPAA.

[322] 15 U.S.C. § 3311(b)(4)(A) (1982).

will more easily find an available market, and may obtain transportation under existing procedures.

Indicated Producers request the Commission to clarify that the first seller may be a shipper under the blanket transportation certificate. Indicated Producers state that there is language in the text of the rule indicating that if a first seller requests transportation service, a separate transportation certificate under section 7(c) is necessary,[323] and request a clarification that the first seller, as well as any other shipper, is entitled to receive transportation under the blanket certificate.[324] The Commission grants the requested clarification that the transportation certificate applies to transportation on behalf of the first seller taking part in the good faith negotiation procedures and to any shipper. This clarification is intended to be consistent with the discussion *supra* regarding upstream and downstream third-party pipelines, however. Thus, although the final rule authorizes and requires transportation by the releasing pipeline on behalf of any shipper-purchaser, the blanket transportation authorization extended to upstream, third-party pipelines is available for their voluntary utilization, but their decision to utilize or not utilize the authorization will be subject to review. Similarly, downstream interconnecting pipelines may not unduly discriminate in the use of their existing transportation authorizations, or authorizations they may obtain in the future. In the vast majority of circumstances then, the Commission anticipates that pipelines both upstream and downstream of the former pipeline purchaser will continue to provide transportation services as before, while billing the actual purchaser or contractor of the transportation service instead of the former pipeline purchaser. Only the former pipeline purchaser is *obligated* to provide transportation to any cus-

[323] Indicated Producers at 21.

[324] *Id.*

tomer or interconnecting pipeline under the transportation authorization established in the final rule. Refusals to transport by upstream or downstream pipelines may be unduly discriminatory or otherwise unlawful, however, and will be given close and prompt scrutiny in the unlikely event they occur. Unlike former pipeline purchasers, upstream pipelines have no incentive not to continue transporting as before. Accordingly, the Commission finds no current need to make use of the transportation certificate mandatory for upstream pipelines.

J. *Transportation Rates*

In the final rule the Commission determined that the transportation thereunder would be provided as far as practicable in accordance with the terms and conditions requested by the first seller and its purchaser and at rates promulgated as part of the rule. The rates were based on the § 284.7 concepts established in Order No. 436 and codified in 18 C.F.R. § 284.7. In order to expedite access of existing firm sales customers to released gas, such customers were given a right of first refusal.

Where an existing firm sales customer requested transportation of released gas within its existing firm sales contract demand, its cost for such transportation was not to exceed that which it would have incurred in purchasing the gas from the releasing pipeline. To achieve this result, the rate was based on the appropriate components of the commodity charge in the customer's applicable sales rate schedule, with a credit for volumes of gas transported against any minimum commodity bill obligation. This rate was essentially the commodity sales rate of the pipeline less purchased gas costs. No demand charge or reservation fee was assessed since that would be recovered from the customer as part of its sales demand rate.

Where an existing firm sales cusotmer requested transportation of released gas in excess of its existing contract

demand, or the gas was transported to any pipeline or customer other than an existing customer on a firm basis, the rate was to be based on a transportation rate schedule on file with the Commission that conformed to 18 C.F.R. § 284.7 and either § 284.8(d) for firm service or § 284.9(d) for interruptible service. (Thus, the firm rate could include an appropriate reservation fee since the costs associated with use of capacity for transportation in excess of contract demand are not otherwise recovered from such customers as part of any sales demand rate.) Until such rates become effective, the pipeline must use the rate in one of the pipeline's rate schedules on file with the Commission which the pipeline determines covers service comparable to the transportation service authorized.

Requests for Rehearing. A number of applicants have raised questions regarding the practical application of the transportation rates established in the final rule. They raise questions about the priority of access to the transportation authorized under Order No. 451, and the relationship of transportation priorities under Order No. 436. Pipeline applicants are concerned that they may underrecover some of their costs and ask that their sales obligations be reduced commensurate with volumes released. Consumers and producers are concerned that the transportation authorization be truly effective in bringing gas to market, and that the transportation rates be non-discriminatory so as to achieve this goal. Distribution companies raise technical questions about the determination of transportation rates under Order No. 451, the impact of existing pipeline tariffs, and the interplay with Order No. 436.

Commission Response. The Commission will not grant the requests of several applicants [325] that a pipeline's sales obligations associated with contract demand for a firm

[325] *See, e.g.*, Transwestern at 18-20; Natural and United at 14.

sales customer exercising its right of first refusal under the rule be commensurately reduced, and converted into a firm transportation obligation. Nothing in the rule is intended to unilaterally affect the existing obligations of the pipeline. However, there is likewise nothing in the rule that prevents the pipeline and the firm sales customer from mutually agreeing to changes in existing obligations, or that prevents the pipeline from filing an amendment to its certificate. The Commission recognizes, however, that a firm sales customer who elects to exercise the right of first refusal and have gas transported in lieu of purchasing gas from the pipeline, without a corresponding reduction in the pipeline's sales obligation, should compensate the pipeline for any costs associated with standing by to resume sales service should the firm sales customer subsequently elect to purchase gas from the pipeline rather than transportation service. Accordingly, the Commission shall grant the applicants' request that pipelines be allowed to assess a standby charge where appropriate.[326] The Commission believes that this charge in conjunction with the rate revisions discussed below will ensure that a pipeline receives neither more nor less for providing transportation than it would for providing sales service. A firm customer purchasing transportation service in excess of contract demand under § 284.225 (d) (2) of the regulations may already be paying a reservation fee conforming to § 284.8 (d).[327] A firm customer purchasing transportation service within contract demand under revised § 284.225 (d) (1) should be subject to the same obligation, unless it is already paying a demand charge related to its sales service.

[326] The Commission does not intend to permit such standby charges to be "loaded" with inappropriate costs so as to make the rate so exorbitant that it prevents operation of the rule.

[327] Where a customer purchases firm service under § 284.8 (d), that section permits the pipeline to impose a reservation fee or charge on the shipper as a condition for providing such service.

Under § 284.225 (d) (1) the Commission intended the pipeline to collect all appropriate transmission, storage, and gathering components in the commodity rate, less purchased gas costs, properly associated with the provision of transportation service. Thus, applicants' assertions of underrecovery, though understandable, are misplaced. Tennessee Gas Pipeline Company expressed the concern, for example, that the credit to the pipeline's minimum commodity bill by volume of gas transported may result in undercollection by the pipeline of the "production cost component" of its sales commodity rate.[328] This is resolved by the Commission clarifying that pipelines may revise their sales rate schedule to recover the costs associated with standing by to serve a firm sales customer who does not reduce contract demand. The standby charge may include production costs if the costs are incurred in providing standby service. Thus, no undercollection would occur. The production cost component should not be included in the transportation rate whether or not transportation is within or in excess of contract demand. If transportation is within contract demand, then a standby charge (associated with sales service) may include production costs. If transportation is in excess of contract demand, then production costs are recovered through the currently effective sales rates. Accordingly, the volumetric credit to the minimum commodity bill in § 284.255 (d) (1) is appropriate. The Commission will amend the regulatory text at § 285.225 (d) (1) to more clearly follow the § 284.7 concept and include all appropriate transportation cost components, and will allow a pipeline to revise its sales rate schedules to provide a standby service. Thus, the rate for equivalent services paid by distributors, end-users, and others will essentially be the same. This will address the concerns of Process Gas Consumers Group and others that distributors should not be entitled to any more favorable trans-

[328] Tennessee at 32-33.

portation rate than any other shipper.[329] This is consistent with Order No. 436 which established that market-responsiveness is best served by transportation rates that are unbundled and cost-based, whether they apply to existing firm sales distribution customers or to other shippers, and whether within, or in excess of, contract demand.

Under revised § 284.225(d)(1), a pipeline shall file for a rate schedule applicable to firm sales customers which meets the requirements of §§ 284.7 and 284.8(d). To the extent the firm sales customer is currently paying a demand charge related to sales service, the pipeline must waive any § 284.8(d) reservation fee that would otherwise be charged. In addition, the pipeline, as already indicated, may include an appropriate revision to its sales rate schedules to recover costs associated with the pipeline's standing by to serve a firm rate schedule customer who does not reduce its contract demand.[330] Volumes of gas transported will continue to be credited against any minimum bill obligation pursuant to § 284.225(d)(1)(iii). Of course, a firm sales customer and a pipeline that mutually agree to reduce the pipeline's sales obligation, will have to the same extent agreed to reduce any credit required under § 284.225(d)(1)

[329] *See, e.g.*, PGC at 10-12.

[330] As is now the case with the rates in §§ 284.225(d)(2) and (3), until the rate is revised § 284.225(d)(1) becomes effective, the pipeline must use the rate in one of the pipeline's transportation rate schedules on file with the Commission which the pipeline determines covers service comparable to the transportation service authorized under § 284.225(d)(1). The Commission emphasizes that the transportation authorization is self-executing and further that the interim rate requirements for the authorized transportation services do not require any separate regulatory approval by the Commission and do not provide the pipeline with any discretion to avoid or delay providing the transportation services under the interim rate provision. Rather, the pipeline must provide the services using a rate schedule already on file.

(iii). Thus, all customers who request firm transportation will be served under the pipeline's firm transportation rate schedule designed in accordance with § 284.7. Existing firm sales customers will be protected from paying twice for the same capacity by the requirement in revised § 284.225(d)(1)(ii) that pipelines must waive the transportation reservation fee to the extent transportation and sales do not exceed their current contract levels.[331]

AGD poses two questions with respect to the § 284.225(d)(2) transportation rates for service "in excess of contract demand" to existing firm sales customers. AGD first asks how this excess is determined and whether daily, monthly, or annual contract demand is used. Second, AGD states that since the rate can only be determined after the fact (*i.e.*, until the contract demand is determined, however it is measured, one cannot determine if it has been exceeded), a rate so defined "offends the 'filed rate doctrine' and lends itself to retroactive ratemaking." [332]

In response to AGD's first question, contract demand should be determined pursuant to the contractual arrangement of the parties. Although under many of the more recently executed gas purchase contracts, contract demand may be measured daily, whatever time frame the applicable contract provides for determining contract demand shall govern. As to AGD's second question, the determination of whether the purchaser is within or in excess of contract demand is inherently different from retroactive ratemaking, which involves a change in an established rate, not a determination of which rate to apply. The filed rate doctrine simply requires that pro-

[331] "The pipeline must waive the transportation reservation fee to the extent that a customer pays for facilities associated with such transportation service through demand charges under its firm sales rate schedule."

[332] AGD at 14.

viders have a rate on file for different components of service, and that no rate is legal other than the filed rate.[333] The situation under § 284.225(d)(2) is no different from that under current tariffs that require a charge for overruns. The rate is on file for overruns, but the rate cannot be charged until overruns occur, just as the reservation fee in § 284.225(d)(2) cannot be charged unless the firm volumes transported are in excess of the sales contract demand, however measured. Thus the filed rate doctrine is in no way offended by § 284.225(d)(2).

Several applicants raise questions related to the adjustment of existing tariff restrictions to comport with the requirements of Order No. 451. The General Service Customer Group note that its members are generally not allowed to purchase natural gas from any natural gas company other than Panhandle Eastern Pipe Line Company (Panhandle) pursuant to Section 1.9 of the General Terms and Conditions of Panhandle's Tariff.[334] Panhandle also seeks guidance on this situation, and notes that full requirements customers purchasing gas under a rate schedule requiring that all of their gas be purchased from the pipeline, but which then purchase gas released under the good faith negotiation procedures, will be in violation of that rate schedule.

The Commission intends that full requirements tariff provisions are waived to the extent necessary to meet the objectives of Order No. 451. Otherwise the right of first refusal granted to existing firm sales customers in Order No. 451 would be a nullity. For a pipeline with a full requirements or sole supplier clause, the pipeline's

[333] Arkansas Louisiana Gas Co. v. Hall, 453 U.S. 571, 578 (1981); Montana-Dakota Utilities Co. v. Northwestern Public Service Commission, 341 U.S. 246, 251-54 (1951).

[334] General Service Customer Group at 4. Seventy percent of the gas sales in 1985 on Panhandle's system were to General Service Buyers and Small General Service Buyers under Panhandle's full requirements tariff provision.

election to bid less than the highest price permitted under its existing contract necessarily includes an agreement to waive any existing contract and tariff provisions that would prevent an existing firm sales customer from exercising its right of first refusal. No further authorization will be necessary as common sense requires this for the final rule to operate as intended. Accordingly, such full requirements or sole supplier tariff restrictions should be deemed waived with respect to firm sales customers who purchase gas released under the final rule. Since the Commission finds no cost shifting involved in these full requirements customers exercising their right of first refusal and requesting transportation, the Commission finds no basis to justify any rate schedule reclassification because of Order No. 451.

Several applicants ask whether transportation on Order No. 436 pipelines should be made pursuant to Order No. 451. Amoco Production Company suggests that where a pipeline exercises its right under the good faith negotiation procedure to discontinue purchases, it should be permitted to transport that gas for the producer unrestricted by the first-come, first-served provisions of Order No. 436.[335] AGD asks for what time period the transportation service is authorized, and also asks how the service relates to the principle of first come, first-served.[336] AGA requests a similar clarification and asks, in addition, where transportation is provided to an existing customer under Order No. 451 and the pipeline subsequently elects to operate under Order No. 436, is the existing customer given a higher priority than any of the pipeline's other existing customers? AGA asks further whether the existing customer could change its receipt or delivery points after the pipeline opted for Order No. 436, or whether it makes

[335] Amoco at 5-6.

[336] AGD at 13-14. AGD also asks how the Order No. 451 service is to be integrated with existing tariffs and service, which question is addressed, *supra*.

any difference whether the existing customer was receiving the Order No. 451 gas within or in excess of contract demand.[337]

To answer the central question, if an Order No. 451 pipeline subsequently becomes an Order No. 436 pipeline, any shippers under Order No. 451 have priority over new shippers; among the pre-existing shippers, they will likely stand in the same priority vis-a-vis themselves after the open-access election under Order No. 436 as they did before it, but this will depend on how their pre-Order No. 436 relationships are constructed. Transportation of gas released by pipelines already participating under Order No. 436 will be made pursuant to Order No. 436 inasmuch as the Order No. 451 transportation authorization is only available to non-open-access pipelines. In some cases, transportation of the released gas through the releasing pipeline on behalf of any purchaser requesting such transportation will continue until the supply is exhausted, in other cases, upon the expiration of a contract.[338] The priorities that would pertain under Order No. 436 if receipt or delivery points were changed, or if deliveries were made within or in excess of contract demand would continue to apply.

AGA indicates that situations exist where gas that may be released under Order No. 451 is currently being transported through some gathering or short-haul pipeline upstream of the releasing pipeline. AGA suggests that if the releasing pipeline continues to transport the gas through this short-haul pipeline it should be made whole in the event it pays the short-haul pipeline for this transportation service.[339] To respond, since the releasing pipeline will no longer be obliged to purchase the released volumes, it is no longer responsible for the transportation of the released volumes with upstream gatherers or short-haul pipelines. Since it is the existing firm sales customer that, having exercised its right of first refusal, will be purchasing directly from the producer, the firm sales customer (or producer-seller) will have to make its own arrangement with the upstream gatherer for transportation into the releasing pipeline.[340]

[337] AGA at 36-37.

[338] 51 Fed. Reg. 22,213 (June 19, 1986). (Authorization for "transportation will continue until the supply is exhausted, or . . . [until] transportation of such gas ceases upon the expiration of a contract where a pipeline subsequently become subject to Order No. 436.") *Id.*

Two remaining questions also appear to warrant clarification. ANR Pipeline Company and Colorado Interstate Gas Company (ANR and CIG) ask whether an existing firm *transportation* customer of a releasing pipeline has any rights of purchase or transportation with respect to released gas, and if transportation for such a non-sales customer is to be firm or interruptible.[340a] The brief answer is that only existing firm sales customers have a vested interest in the gas released under the final rule, and only they will have a right of transportation *and* of first refusal thereunder. If they do not exercise their

[339] AGA at 37.

[340] This situation appears related to the issue of whether the blanket transportation should be expanded to cover all jurisdictional transportation arrangements applicable to the gas released, whether upstream or downstream. As discussed in part IV. I., *supra*, the blanket transportation authorization applies to the pipeline releasing gas under Order No. 451 and to any upstream pipeline, and is required to be utilized as a mandatory obligation for the former purchasing pipeline and as a voluntarily assumable blanket authorization for upstream "feeder" pipelines. Transportation through pipelines downstream of the releasing pipeline will be pursuant to section 7(c) certificates or pursuant to Order No. 436. Thus, transportation from the seller to the former pipeline purchaser or to any interconnecting line may proceed without further regulatory approval, with billing of applicable rates now to be made to the parties actually purchasing the transportation services.

[340a] ANR and CIG at 28.

right of first refusal, however, transportation is available to *all* sales and transportation customers pursuant to § 284.225(c), depending on whom the producer seller executes an agreement with.

Florida Gas Transmission Company (Florida Gas) states that the Commission has not expressly limited its rule to take into account factors such as full requirements customers and "transportation rates under existing tariffs which either do not exist or are different from those required under the Commission's rule." [340b] The Commission has already indicated, *supra*, that gas transportation under Order No. 451 operates *pro tanto* to supersede full requirements or sole supplier tariff obligations. Florida Gas' statement regarding transportation tariff rates that do not exist is puzzling. The reference is apparently to the language in §§ 284.225(d)(1), (2) and (3) that requires the pipeline to use as an interim rate "the rate in one of the pipeline's transportation rate schedules on file with the Commission which the pipeline determines covers service comparable to transportation service authorized under this section." [340c] The Commission does not understand Florida Gas' objection and believes that Florida Gas and other pipelines will have sufficiently comparable rates on file until the new § 284.7 rate is established. In particular circumstances, if a pipeline company requires further guidance on this issue, it may request it on a case-by-case basis.

V. OTHER ISSUES

A. *Gas Subject to Rule*

1. *Pipeline and Affiliate Production*

In Order No. 451 the Commission determined that old gas produced by an interstate pipeline or an affiliate of

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[340b] Florida Gas at 11.

[340c] *See* former 18 C.F.R. §§ 284.225(d)(2) and (3) and revised § 284.225(d)(4).

an interstate pipeline for the pipeline's system supply would be eligible for the new alternative ceiling price, subject to the requirements of the affiliated entities test set forth in section 601(b)(1)(E) of the NGPA.[341] The Commission noted that such eligibility would be consistent with existing Commission policy under Order Nos. 391 and 391-A.[342] Those orders implemented the Supreme Court decision in *Public Service Commission of New York v. Mid-Louisiana Gas Co.*[343] that interstate pipelines are entitled to have intracorporate transfers of gas from their own wells treated as "first sales" and thus be subject to the pricing provisions of the NGPA. After the issuance of Order No. 451, the United States Court of Appeals for the D.C. Circuit remanded Order Nos. 391 and 391-A to the Commission for reconsideration of whether pipelines are entitled to the same prices for their own natural gas production under section 104 of the NGPA as are independent producers.[344]

APGA requests the Commission to grant rehearing on the applicability of the alternative ceiling price of Order No. 451 to pipeline production and to postpone a final ruling thereon pending its action on the remand of Order Nos. 391 and 391-A.[345] APGA also argues that the potential for abuse of the good faith negotiation procedures between an interstate pipeline and its production

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[341] Section 601(b)(1)(E) provides that a first sale of natural gas between an interstate pipeline and its affiliate within the NGPA's maximum lawful price shall be deemed to be just and reasonable if the amount paid does not exceed the amount paid in comparable first sales between persons not affiliated with the interstate pipeline.

[342] 49 Fed. Reg. 33,849 (Aug. 27, 1984); 50 Fed. Reg. 14,374 (Apr. 12, 1985); 18 C.F.R. § 270.203 (1986).

[343] 463 U.S. 319 (1983).

[344] Phillips Petroleum Co. v. FERC, 792 F.2d 1165 (D.C. Cir. 1986).

[345] APGA at 69-71.

division or affiliate supplier is very high, and that it will be difficult for the Commission to "police" such abuses under the affiliated entities test. Therefore, APGA urges the Commission not to apply the alternative ceiling price for old gas to affiliate or pipeline production. In the alternative, APGA urges the Commission to impose special safeguards on renegotiations of the price of affiliate or pipeline production, such as mandatory arbitration or mediation by an impartial third party, auditing of renegotiations by the Commission staff, or spot auditing of renegotiated prices, to assure compliance with the affiliated entities test.[346]

In *Phillips Petroleum Co. v. FERC, supra*, the Court noted that prior to the enactment of the NGPA, pipeline production from wells drilled on or before January 1, 1973, (old wells) on leases acquired on or before October 7, 1969, (old leases) was priced on the basis of the actual cost while independent producer rates were based on average costs of production within an area, or nationwide, as was pipeline production from new leases and new wells on old leases. Although the Commission attempted to perpetuate this pricing system after enactment of the NGPA by defining "first sale" to exclude intracorporate transfers of pipeline production from old wells on old leases,[347] the Commission was reversed by the Supreme Court in *Mid-Louisiana, supra.* The Commission then issued regulations in Order Nos. 391 and 391-A which applied the same ceiling prices under section 104 to pipeline production as to gas purchased from independent producers, asserting that, "the *Mid-Louisiana* decision requires parity treatment for producer and pipeline production." [348] However, the Court of Appeals in the *Phillips*

[346] APGA at 71-73.

[347] Order No. 58, 44 Fed. Reg. 66,577 (Nov. 20, 1979); Order No. 98, 45 Fed. Reg. 53,091 (Aug. 11, 1980); 18 C.F.R. § 270.203 (1983).

[348] Order No. 391-A, 50 Fed. Reg. at 14,378, 31 FERC ¶ 61,036 (Apr. 10, 1985).

case concluded that the Commission misinterpreted *Mid-Louisiana* as requiring absolute parity of pricing. According to the Court in *Phillips*, section 104 of the NGPA could be interpreted to permit parity of pricing for independent producer and pipeline production, but the Commission would have to offer a reasoned rationale for that interpretation and not base such a conclusion on its erroneous belief that *Mid-Louisiana* mandated such a result.

The Commission must determine on remand of the *Phillips* case whether section 104(b)(1) of the NGPA incorporated the cost-of-service rate for each particular pipeline's production from its old wells on old leases or applied the just and reasonable rates established by the Commission for independently produced gas to such pipeline production. However, in Order No. 451 the Commission established an alternative ceiling price under the authority of section 104(b)(2) and the just and reasonable standard of the NGA, and determined that pipeline production would be eligible for that alternative ceiling price, along with all other old gas, regardless of what the otherwise applicable ceiling price might be under section 104(b)(1). Therefore, the resolution of the issue remanded to the Commission in *Phillips*, a question of interpreting section 104(b)(1), does not affect the Commission's decision in this proceeding that the alternative ceiling price for old gas is available for pipeline production.

The Commission believes that interstate pipelines and their affiliate suppliers should be eligible to receive the alternative ceiling price for old gas established in Order No. 451 for the same reasons and under the same conditions as independent producers. The reasons adduced in Order No. 451 for permitting an increase in old gas prices apply to gas owned by pipelines as well as gas owned by independent producers.

The Commission intends to give special scrutiny to a pipeline's recovery of its costs of purchasing repriced old gas from its own production division or an affiliate and believes that the affiliated entities test will effectively serve to limit a pipeline's recovery of such costs to levels no higher than the costs of comparable purchases from other non-affiliated suppliers. While there are unresolved issues concerning the mechanics of applying the affiliated entities test,[349] there should be no more difficulty in applying that test, when those issues are resolved, to prices paid by a pipeline to its affiliated suppliers or its own production division for repriced old gas than for other categories of gas. It is thus unnecessary to impose any "special safeguards" on these transactions beyond the requirements of the affiliated entities test. Accordingly, the Commission will deny APGA's application to grant rehearing on this issue.

2. *Minimum Rate and Fixed-Price Gas*

The Commission noted in Order No. 451 that contracts for the sale of old gas at the minimum rate or at a fixed rate less than the applicable maximum lawful price would not be eligible for renegotiation under the good faith negotiation procedures because such contracts lack the contractual authority to increase prices necessary to invoke those procedures. Nevertheless, the Commission said that old gas sold under such contracts could be repriced up to the alternative ceiling price if, and only if, the purchaser agreed to pay a higher price after the effective date of Order No. 451.

APGA argues that the alternative ceiling price for old gas should not apply to gas sold under minimum rate or fixed-price contracts, even if the purchaser agrees to pay a higher price, because the producers "hold the trump

[349] *See, e.g.*, Tennessee Gas Pipeline Company, 30 FERC ¶ 63,027 (1985), currently pending before the Commission on exceptions to the initial decision.

cards under the . . . good faith renegotiation procedure . . . [and] will have the ability to extract major concessions from pipelines." APGA also argues that the Commission should not give producers the right to collect increased rates under their lowest-cost minimum rate and fixed-price contracts without giving pipelines a corresponding right to renegotiate price decreases under their high-cost "problem" contracts.[350]

Since the possibility of abandonment under the good faith negotiation procedures is not available for sales under minimum rate or fixed-price contracts, the Commission fails to see how a producer can secure a purchaser's agreement to pay a higher price for old gas subject to such contracts without making some concession of comparable value to the purchaser. In fact, purchasers have the same right to seek voluntary renegotiations of price under their high-cost problem contracts as producers with minimum rate or fixed-price contracts. Accordingly, the Commission sees no reason for disqualifying old gas sold under minimum rate or fixed-price contracts from eligibility for the alternative ceiling price, provided the purchaser agrees to a higher price.

3. *Optional Procedure Certificates*

Tenneco Oil Company and Felmont Oil Corporation seek clarification or rehearing on the applicability of the alternative ceiling price of Order No. 451 to old gas sold under an "optional procedure certificate" issued under the authority of § 2.75 of the Commission's regulations. Nothing in Order No. 451 addresses optional procedure certificates.

In 1972 the Federal Power Commission established a special procedure for certification of new gas sales in interstate commerce at rates in excess of the otherwise applicable maximum lawful rate if the producer waived

[350] APGA at 73-74.

its right to seek future rate increases. Both Tenneco and Felmont hold certificates issued under those procedures under which old gas is currently being sold at contract rates well below current market prices—57 cents per Mcf under a Tenneco contract and 45 cents per Mcf under a Felmont contract. Tenneco and Felmont ask the Commission to clarify or to amend, if necessary, the regulations promulgated in Order No. 451 so they will have an opportunity under the good faith negotiation procedures to renegotiate higher prices for old gas sold under their optional procedure certificates.

In Order Nos. 64 and 64-A,[351] the Commission determined that producers operating under optional procedure certificates could not collect NGPA prices for gas not removed by section 601 of the NGPA from the Commission's NGA jurisdiction. The United States Court of Appeals for the Fifth Circuit upheld those orders.[352] Even if a contract underlying an optional procedure certificate provides contractual authority for escalation to higher rates found just and reasonable by the Commission, rate increases would be barred by the producer's agreement to waive the effect of indefinite price escalator clauses in order to receive an optional procedure certificate.[353] Producers are also barred from increasing their rates except in accordance with the originally certificated contract by the requirement of § 2.75(m) of the Commission's regulations that they waive their rights to make rate filings under section 4 of the NGA. Holders of optional procedure certificates will therefore be ineligible to initiate renegotiations of their underlying contracts under the good faith negotiation rule because such contracts will lack indefinite price escalator clauses, or their

[351] 45 Fed. Reg. 5685 (Jan. 24, 1980); 45 Fed. Reg. 16,171 (Mar. 13, 1980).

[352] Columbia Gas Development Corp. v. FERC, 651 F.2d 1146 (5th Cir. 1981).

[353] *Id.* at 1153; 18 C.F.R. § 2.75(f) (1986).

rights under such clauses will have been waived in order to qualify for the certificate. However, purchasers may voluntarily negotiate with their producers to reprice old gas within the new alternative ceiling price of Order No. 451. If a purchaser agrees to pay increased prices for such gas, a producer may file a petition for a waiver of the regulation's prohibition against rate filings under Section 4 of the NGA.[354]

4. *Existing contracts with area rate clauses*

The Independent Petroleum Association of America (IPAA) notes that the applicability of the good faith negotiation procedures is limited to contracts that provide authority for the first seller to collect a higher price upon establishment by the Commission of a higher maximum lawful price. IPAA argues that this test "leaves open" all of the interpretive issues addressed by the Commission in the Order No. 23 series[355] regarding whether area rate clauses in existing contracts permit the collection of NGPA ceiling prices. IPAA suggests that the Commission declare that a contract with any form of area rate clause is eligible for renegotiation under the good faith negotiation procedures.

The Commission declines to adopt this suggestion, but believes that past proceedings under Order No. 23-B have already resolved most issues of contract interpretation that might arise under the good faith negotiation rule. Order No. 23-B established certain procedures to determine whether particular price escalation clauses authorize increases to NGPA maximum lawful prices. The most commonly discussed price escalation clause, called an "area rate" clause, escalates the price to whatever lawful rate the Commission allows in an area rate proceeding. Thou-

[354] *Id.* at 1160.

[355] Order No. 23, 44 Fed. Reg. 16,895 (Mar. 20, 1979); Order No. 23-B, 44 Fed. Reg. 38,834 (July 3, 1979); Order on Rehearing of Order No. 23-B, 44 Fed. Reg. 48,174 (Aug. 17, 1979).

sands of area rate clauses have been filed by pipelines as part of their "evidentiary submission"[356] and reviewed under the Order No. 23-B procedures. To the extent area rate clauses have been found under those procedures to authorize escalation to NGPA prices, such clauses provide authority for escalation to the alternative ceiling price established by the Commission in Order No. 451. Nevertheless, the Commission cannot say that an existing contract with "any form" of area rate clause will be eligible for renegotiation under the good faith negotiation rule. Whether a contract provides authority to collect a higher price upon establishment by the Commission of a higher maximum lawful price depends on the language of the contract and the intent of the parties. Unresolved disputes concerning such contractual authority may be resolved under the procedures established by Order No. 23-B. However, the argument frequently made in Order No. 23-B proceedings, that area rate clauses authorize escalation to higher rates set by the Commission but not to the NGPA rates set by Congress, will not likely be available to protest the authority of area rate clauses to increase rates to the Commission-set rates of Order No. 451.

B. *Block Billing*

In the final rule the Commission concurred with the view of most commenters that the block billing[357] pro-

[356] *See* 18 C.F.R. § 154.94(j) (1984).

[357] Block billing would require pipelines to bill their customers separately for old gas (Block 1) and new gas (Block 2). Block 1 old gas is gas which was committed to interstate commerce when the NGPA was enacted. This gas is subject to the relatively low price ceilings established by NGPA sections 104, 106(a) and 109. Block 2 new gas is gas whose price has been decontrolled or is subject to the relatively high incentive prices established by other sections of the NGPA. Under the block billing proposal, a pipeline's customers could purchase a specified percentage of the pipeline's Block 1 gas based on their level of purchases during the period 1979-1984.

posal in Docket No. RM85-1-000 (Part D) and the Department of Energy proposal that was adopted in modified form by the final rule were to a large extent mutually exclusive. The Commission indicated that any action on block billing would be deferred to the Docket No. RM 85-1-000 proceedings.

Rehearing Requests. Certain applicants question the Commission's decision to defer action on block billing.[358] Panhandle, for example, asserts that, "[r]ather then taking steps which would require producers to sell gas at market prices, the Commission [in Order No. 451] is attempting to provide higher price levels to producers while otherwise maintaining the contractual status quo . . . ."[359] KP&L argues that the Commission erred "by failing to consider *now* its block billing proposal,[360] and that Order No. 451 does not explain why the block billing proposal does not present an alternative superior to the rule adopted. APGA, for its part, also argues that block billing was a superior alternative for resolving the disparity between old and new gas prices. APGA asserts further that Order No. 451 exceeds the Commission's statutory authority, but block billing would correct the pricing distortions the Commission found to be unjust and unreasonable in the final rule without exceeding the breadth of its statutory authority. APGA states that the Commission has sounded the "death knell" for the block billing proposal.[361]

Commission Response. The Commission believes it is premature for applicants to characterize Order No. 451 as sounding the final tocsin for the block billing proposal. The Commission does intend to review that proposal at a

[358] See, *e.g.*, APGA at 74-78; KP&L *et al.* at 22-24; and Panhandle and Trunkline at 10-11.

[359] Panhandle and Trunkline at 11.

[360] KP&L *et al.* at 22.

[361] APGA at 75.

date after Order No. 451 has an opportunity to operate so that its effects can be gauged. Based on the comments received, the Commission determined that the benefits of Order No. 451 might have been undercut, or made more difficult to measure, had the proposal been put into effect simultaneously with Order No. 451. Moreover, there was evidence that the block billing proposal would merely have shifted inefficiencies to different parts of an already distorted market.[362] It was argued, for example, that the anticipated consumer savings from block billing would not reach consumers because a distributor entitled to a large block of old gas (Block 1) may, by rolling-in Block 2 costs, obscure the true value of the overall supply to its customers, but at a lower level in the distribution chain.[363] After analysis of the evidence compiled in this proceeding, the Commission determined that the most direct means of avoiding market distortion is by eliminating the artificially low gas cushion.

Contrary to the assertions of Panhandle and others, the rule adopted does not maintain the "contractual status quo" but rather offers more of an opportunity for mutuality in negotiations.[364] Under block billing, the pipeline would not be free to offer price changes for old gas, but under Order No. 451 it is free to establish any negotiating posture it wishes, *and* may also seek renegotiation of other contracts. The Commission intends to make

[362] *See* Supplemental Comments of Texaco Inc., filed Feb. 25, 1986, Docket No. RM86-3-000, at 9-10.

[363] *See* J. Kalt "Old Gas Decontrol, FERC's Block Billing for Pipelines, and the Winners and Losers in Natural Gas Policy" (Study sponsored by Natural Gas Supply Association) (Harvard University, Department of Economics 1985) at 15. ("In so far as distribution companies are likely to engage . . . in rolled-in pricing of their own, Block Billing would serve primarily to push the problems of gas pricing one step further down the distribution chain.")

[364] *See* Panhandle and Trunkline at 11.

a final disposition of the block billing proposal in due course, but will do so in Docket No. RM85-1-000 (Part D).

In essence, those applicants objecting to the Commission's deferral of action on block billing would have had the Commission exercise its judgment differently. As with so many issues in this final rule, the Commission could have drawn a line elsewhere—perhaps to adopt block billing concurrently; or perhaps to reject it on the merits now. That the Commission instead wished the processes in Order No. 451 to operate for a time without concurrent implementation of block billing (which many commenters doubted even could be administered concurrently),[365] does not make the Commission's decision unreasonable or outside its authority.[366]

C. *Response to Administrative Law and Procedural Claims*

1. *Transportation and Right of First Refusal Provisions*

Requests for Rehearing. Several applicants argue that the Commission failed to provide commenters with adequate notice and an opportunity to comment on the transportation provisions and the right of first refusal provisions adopted in Order No. 451.[367] Applicants point out that DOE's initial proposal for Order No. 451 contained no mention of transportation for gas released under the

[365] 51 Fed. Reg. 22,210 n.271 (June 18, 1986).

[366] *See* Capital Cities Communication, Inc. v. FCC, 554 F.2d at 1139 (1976). Also, where the Commission exercises its remedial authority, its discretion is "if anything, at zenith." Niagara Mohawk Power Corp. v. FPC, 379 F.2d 153, 159 (D.C. Cir. 1967).

[367] *See e.g.*, ANR Pipeline Company and Colorado Interstate Westcoast Transmission Company, Ltd. and Westcoast Resources, Inc.; KN Energy, Inc.; Northern Distributor Group; American Public Gas Association; and Northwest Central Pipeline Corporation.

good faith negotiation procedures or a right of first refusal. Therefore, they argue that by adopting these provisions, the Commission violates the requirements of the Administraitve Procedure Act (APA) that agencies provide notice, a concise statement of the basis and purpose of the proposed rule, and an opportunity to comment.[368] According to these applicants, the Commission did not have an opportunity to adequately examine the impact of the transportation requirements or the right of first refusal on the wide range of interests that will be affected by the adoption of these provisions. Additionally, applicants argue that persons adversely affected by the blanket transportation and right of first refusal provisions were not afforded an opportunity to file comments and otherwise participate in this rulemaking proceeding. Applicants, therefore, request the Commission to either vacate Order No. 451 because of this legal deficiency, or invite additional comment.

Commission Response. The final rule in this proceeding did not violate the requirements of the APA. Although DOE's proposal and the Commission's notice of procedural schedule preceding Order No. 451 did not specifically provide provisions for transportation and the right of first refusal in connection with the good faith negotiation rule, the Commission was not required to renotice the new provisions and provide for additional comments.

Federal agencies have considerable flexibility under the APA to make changes—even substantial changes—in final rules based on comments submitted during the comment period without renoticing the new provisions.[369] Rulemaking proceedings would never be terminated if

[368] 5 U.S.C. § 553(b) (1982).

[369] *See* Mid-Tex Elextric Cooperative, Inc. v. FERC, 773 F.2d 327, 339 (D.C. Cir. 1985); Pennzoil Co. v. FERC, 645 F.2d 360, 371 (5th Cir. 1981); American Iron & Steel Institute v. EPA, 568 F.2d 284, 293 (3rd Cir. 1977); International Harvester Co. v Ruckelshaus, 478 F.2d 615, 632 n.51 (D.C. Cir. 1973).

the APA were interpreted to require starting the proceeding over again each time the Federal agency modifies a proposed rule in response to comments submitted during the proceeding.[370] As long as the changes represent a logical outgrowth of the initial notice, or develop the rule originally proposed, neither the APA nor the courts require Federal agencies to provide interested persons wiht a new opportunity to comment.[371]

The Commission concludes that the notice for Order No. 451 fairly apprised interested persons of the issues before the Commission. The Commission believes that the public could determine that gas released under the good faith negotiation procedures involved the issues of transportation and protecting the public interest. In fact, a number of commenters raised the transportation issue in their initial comments. Several commenters expressed concern that pipelines might release gas under the good faith negotiation rule, and then refuse to provide transportation for the released gas to other purchasers.[372] These commenters proposed several alternative solutions to the transportation problem. The Commission notes that since these issues were raised in initial comments, an opportunity was provided for response to these comments not only in reply comments,[373] but also during the public hearing.[374]

[370] International Harvester Co. v. Ruckelshaus, 478 F.2d 615, 632 n.51 (D.C. Cir. 1973); Kennecott v. United States EPA, 780 F.2d 445, 459 (4th Cir. 1985).

[371] Connecticut Light and Power Co. v. NRC, 673 F.2d 525, 533 (D.C. Cir.), *cert. denied*, 459 U.S. 835 (1982); *see also*, Chocolate Manufacturers Ass'n of United States v. Black, 755 F.2d 1098, 1102 (4th Cir. 1985).

[372] *See e.g.*, Texaco, Inc. (Texaco); Natural Gas Supply Association (NGPA); Indicated Producers; and PGC.

[373] *See e.g.*, PGC; Indicated Producers; MPC/NASUCA; and Exxon Company.

[374] *See e.g.*, Nicholas J. Bush, NGSA; Charles Jordan, Chevron U.S.A.; Ralph Pearson, Texaco; Ken Notary, Chemical Manufacturing Assn.; William Bennett, Amoco; and Edward Grenier, PGC.

The initial comments, the alternatives proposed in the initial comments, the reply comments, and the testimony presented at the public hearing, made it clear to the Commission that without some provision for transportation added to the final rule, producers could not effectively market the released gas to other customers. Therefore, the Commission concluded from comments submitted that there was no assurance that first sellers could market released gas unless their existing purchasers are operating under the open access transportation provision of Order No. 436.[375] In addition, the Commission concluded that in order for the benefits of Order No. 451 to be realized in terms of both supply and price response, released gas must be marketed in an efficient and effective manner, and therefore promulgated the transportation provisions.

Specifically, the Commission provided limited blanket authority for an existing pipeline purchaser to transport gas released under the good faith negotiation provisions of Order No. 451. In particular, pipelines that release gas must transport any gas released to existing customers or to any interconnecting pipeline, as a condition of the ability of the existing pipeline purchaser to terminate purchases of gas from a first-seller under the Order No. 451. This condition would ensure that the price for released gas will continue to be competitive. Without this condition the Commission concluded that both consumers and pipelines would be restricted in their access to gas supplies released under the rule.

The Commission granted the right of first refusal to provide pipeline's firm sales customers, primarily local distribution companies, the ability to protect their access

[375] As explained more fully in Order No. 451 and elsewhere in this order on rehearing, the Commission found it necessary to include transportation provisions which would ensure availability of transportation service if a pipeline were not operating under the transportation authority of Order No. 436.

to adequate gas supplies at reasonable costs, since they relied on the pipelines continued access to such gas under its service obligations. The right of first refusal was a logical outgrowth of the abandonment provisions of the good faith negotiation rule. In particular, no natural gas company may abandon jurisdictional facilities, or service rendered by jurisdictional facilities absent a finding that gas supplies are depleted, service is unwaranted, or "that the present or future public convenience or necessity permit such an abandonment."[376] The right of first refusal supports the Commission's finding that the abandonments permitted under the good faith negotiation rule are in the present or future public convenience or necessity.

The Commission also recognized that the right of first refusal could not be exercised unless transportation services are available to the customer. Hence, under the final rule, if a pipeline purchaser chooses to terminate purchases of gas, the right of first refusal and the limited transportation authority ensure that the pipeline's existing customers, especially firm sales customers, have a means of keeping the released gas on-system and of getting the gas transported for their use.

The Commission emphasizes that an ongoing dialogue, which began with initial comments filed in this proceeding, continues as the Commission reviews and responds to the petitions for rehearing. The Commission concludes therefore that the adoption of the transportation provision and the right of first refusal were logical outgrowths from the original DOE proposal and the comments thereon filed with the Commission. In addition, the Commission believes that the proposal and comments adequately framed the issues so that commenters were aware of the need to include transportation authority and the right of first refusal in the final rule and had an

[376] 15 U.S.C. § 717f(b) (1982).

adequate opportunity to present their views in reply comments, the public hearing, and on rehearing.

2. *Environmental Impacts.* NEPA requires Federal agencies to prepare an environmental impact statement (EIS) any time their actions will or may have a significant effect on the quality of the human environment.

Rehearing Petitions. Northwest Central and KN Energy argue that Order No. 451 violates section 102 (2)(c) of the National Environmental Policy Act (NEPA).[377] In particular, these applicants argue that the Commission, in violation of NEPA's procedural requirements, failed to consider the environmental impact of raising the price of old gas, which may cause some industrial customers to switch from natural gas to No. 6 fuel oil.

Commission Response. The Commission does not believe that it needs to perform a NEPA review of Order No. 451. An environmental analysis of any major Federal action is premised on the existence of a foreseeable direct connection between the Federal action and an environmental effect. This rulemaking has no such foreseeable direct connection, both because of the nature of the rulemaking and because of the rulemaking's relationship to the natural gas marketplace.

With respect to the nature of the rulemaking, Order No. 451 does no more than allow producers to collect a higher price for old gas or to seek alternative markets for their gas pursuant to the Commission's statutory authority. Order No. 451 does not impose any obligation on any person to purchase or sell old gas. It does not require or authorize any person to construct facilities for these purchases or sales. The order by itself does not directly cause any activities having environmental effects.

[377] 42 U.S.C. § 4332(2)(c) (1982).

With respect to the rulemaking's relationship to the natural gas marketplace, the rulemaking is coincident to a variety of economic conditions and activities which themselves may independently have environmental and economic impacts. These intervening economic conditions and activities include the terms of existing and future natural gas contracts, patterns of industrial, commercial and residential gas consumption, the level of industrial activity, general economic conditions, the price of alternative fuels, the marketability of gas, fuel-switching in relation to conversion costs, and gas conservation efforts. In this instance, the rulemaking cannot be said to have any direct environmental effect whatsoever in light of these intervening considerations. In this connection, Northwest Central's[378] argument, that this rulemaking will affect the environment adversely due to fuel-switching that results from higher gas prices, is inaccurate. It fails to account for the marketability of the gas, the price of alternative fuels, and other intervening conditions that will restrain purchasers from agreeing to unnecessarily high prices for old gas and prevent producers from seeking higher prices or the abandonment of service obligations if the producer and pipeline fail to reach agreement under the good faith negotiation rule.

It is unnecessary for the Commission to undertake a NEPA review in this proceeding because of the diverse considerations that are involved. In fact, the Commission has determined that environmental review under NEPA is not necessary if the variables involved render any environmental consequences unforseeable.[379] The

[378] Northwest Central at 37.

[379] *See* Opinion No. 770, "National Rates for Jurisdictional Sales of Natural Gas," RM75-14, issued July 27, 1976, 56 FPC 509, *reh. denied*, Opinion No. 770-A, 56 FPC 2698 (1976), *aff'd*, American Public Gas Ass'n v. FPC, 567 F.2d 1016 (D.C. Cir. 1977), *cert. denied*, 435 U.S. 907 (1978); Order No. 94-C, "Regulations Implementing Section 110 of the Natural Gas Policy Act of 1978 and

Commission believes in the continued validity of this approach. NEPA does not require agencies to engage in environmental impact statements, when the causal relationship between a Federal action and certain environmental effects is remote and conjectural.[380] The Commission believes that this principle applies here. There is no direct connection between Order No. 451 and any changed patterns of consumption or other market effects, much less the environmental effects of any such actions, that would warrant examination of the issue beyond the economic considerations that the Commission has already taken into account.[381]

Establishing Policy Under the Natural Gas Act," RM80-47-002, *et al.*, issued May 24, 1983, FERC Stats. & Regs., Regulation Preambles (1982-1985), ¶ 30,454.

[380] *See e.g.*, Citizen Advocates for Responsible Expansion v. Dole, 770 F.2d 423 (5th Cir. 1985); Save the Bay, Inc. v. United States Corps of Engineers, 610 F.2d 322, 326 (5th Cir. 1980); Sierra Club v. Hodel, 544 F.2d 1036, 1039 (9th Cir. 1976); Citizens Committee Against Interstate Route 675 v. Lewis, 542 F. Supp. 496, 531 (S.D. Ohio 1982). In addition, the regulations of the Council on Environmental Quality, the agency responsible for administering NEPA, also recognize that there are some Federal actions which, by their nature, do not raise the kind of environmental concerns against which NEPA is intended to guard. These are described as actions which do not individually or cumulatively have a significant effect on the human environment. Neither an environmental assessment nor an environmental impact statement is required for such actions. *See* 40 C.F.R. § 1508.4 (1985).

[381] Of particular note are Section IV. D., Supply Response; Section IV. E., Price Response, and Section IV. F., Good Faith Negotiation Rule. Applicants' allegations that the Commission has violated its own regulations by not performing NEPA review are incorrect. The Commission's own regulations require the preparation of an environmental impact statement when the Commission determines that the contemplated activity is a "major federal action significantly affecting the quality of the human environmental." The regulations do not address the situation at issue in this order where the Commission believes that no NEPA review is required. *See* 18 C.F.R. §§ 2.80-2.82 (1986).

D. *Filing Fees*

In Order No. 451 the Commission said there will be no change in applicable rate filing requirements but that filing requirements would be waived for sales of gas abandoned under the good faith negotiation rule and resold under a blanket certificate.[382] Indicated Producers request the Commission also to waive fees applicable to filings made by producers to collect a price for old gas renegotiated under the rule.[383] Absent such a waiver, there will allegedly be a disincentive to voluntary renegotiation of old gas prices with existing purchasers and an incentive to seek abandonment under the good faith negotiation procedures and resell the abandoned gas under a blanket certificate. IPAA asserts that renegotiations under the rule will trigger an "avalanche" of producer rate filings, which the Commission may wish to avoid by amending the regulations to waive rate filings engendered by negotiations under the rule.[384]

Small producers, *i.e.*, producers not affiliated with a major pipeline company and with jurisdictional sales of less than 10,000,000 Mcf of natural gas per year, are exempt from all rate filing requirements under existing regulations to the extent these rates are authorized by contract.[385] The Commission does not believe that rate change filings by large producers resulting from Order No. 451 will impose an unmanageable administrative burden on the Commission's staff or be unduly burdensome to the producers. The filing fee for producer rate changes is $400, an amount that recovers the costs of processing such filings.[386] The Commission does not be-

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[382] 51 Fed. Reg. 22,209-10 (June 18, 1986).

[383] Indicated Producers at 30-31.

[384] IPAA at 4-5.

[385] 18 C.F.R. § 157.40 (1986).

[386] 18 C.F.R. § 381.203 (1986).

lieve that the filing fee will substantially affect a large producer's decision to renegotiate the price with an existing purchaser or seek abandonment under the good faith negotiation procedures. Accordingly, the Commission will not waive the filing requirement or the filing fees for producer rate change filings resulting from renegotiated old gas prices under Order No. 451.

E. *Requests for Stay*

A relatively small number of the applications for rehearing included requests for stay of the effectiveness of Order No. 451. On July 28, 1986, the Commission denied the requests of KN Energy, Inc. and certain Florida Cities for an immediate stay of the effectiveness of the final rule.[387] At that time the Commission noted that several other applicants had requested a stay pending judicial review, in the event their applications for rehearing were denied. These applicants included the American Public Gas Association (APGA), the Interstate Power Company, the Northern Distributor Group, and Laclede Gas Company. On December 5, 1986, AGA, APGA, AGD and UDC also filed a joint petition for a stay of the effective date of the good faith negotiation procedures. The Commission has evaluated the arguments for rehearing.

In reviewing requests for stay, the Commission applies the standard set forth in the Administrative Procedure Act, 5 U.S.C. § 705 (1982), *i.e.*, if the Commission finds that "justice so requires."[388] For essentially the reasons

[387] 51 Fed. Reg. 27,529 (Aug. 1, 1986), 36 FERC ¶ 61,102 (1986).

[388] *See, e.g.*, Arkansas Louisiana Gas Co., 23 FERC ¶ 61,324 (1983). The applicants have framed their arguments under the four factors listed in Virginia Petroleum Jobbers Ass'n. v. FPC, 259 F.2d 921 (D.C. Cir. 1958), and Metropolitan Area Transit Comm. v. Holiday Tours, Inc., 559 F.2d 841 (D.C. Cir. 1977). Even using those factors, the Commission believes the requests for stay should be denied. As discussad more fully in the text of this order, the Commission has exercised its broad jurisdiction over the parties

set forth in its order of July 28, 1986,[389] the Commission finds that justice does not require postponing the effective date of Order No. 451, and the requests for stay not heretofore disposed of are therefore denied.

F. *Effective Date and Paperwork Reduction Act Statement*

The amendments to the Commission's regulations adopted in this order on rehearing will become effective on [insert date 30 days after publication of this order in the *Federal Register*]. The effectiveness of the date on which a producer is permitted to make a nomination request under the good faith negotiation rule in Order No. 451 (18 C.F.R. § 270.201) is further postponed until [insert date 30 days after publication of this order in the *Federal Register*].

The information collection provisions in this rule are being submitted to the Office of Management and Budget

and contracts affected by Order No. 451 in a balanced way that cannot fairly be characterized as *ultra vires*. Assertions of irreparable harm are also unfounded. Even if the courts modify Order No. 451 on review, only money adjustments need be made to make parties whole. Economic damages, even if they do derive from agency action, are insufficient to constitute "irreparable harm." *See, e.g.*, Wisconsin Gas Co. v. FERC, 758 F.2d 669 at 674 (D.C. Cir. 1985), *citing* Virginia Petroleum Jobbers Ass'n., 259 F.2d at 925. Moreover, Order No. 451, by providing a significantly greater degree of market-responsiveness in the gas markets will benefit a broad spectrum of the public. A delay in implementation will harm this broad spectrum of parties which includes consumers, end-users, local distribution companies, producers, marketers and pipelines generally. On balance, the long-term public interest benefits of the rule to consumers and to the industry as a whole outweighs any initial detriment to those few entities that benefited from a distorted market. This militates against any stay of the rule and instead underscores the need for its prompt implementation.

[389] Order Denying Petitions for Stay of Order No. 451, Docket Nos. RM86-3-006, RM86-3-062, 36 FERC ¶ 61,102, 51 Fed. Reg. 27,529 (Aug. 1, 1986).

(OHB) for its approval under the Paperwork Reduction Act [390] and OMB's implementing regulations.[391] Interested persons can obtain information on these information collection provisions by contacting the Federal Energy Regulatory Commission, 825 North Capitol Street, N.E., Washington, D.C. 20426 (Attention: Ellen Brown (202) 357-8272). Comments on the information collection provisions can be sent to the Office of Information and Regulatory Affairs of OMB, New Executive Office Building, Washington, D.C. 20503 (Attention: Desk Officer of the Federal Energy Regulatory Commission).

List of Subjects:

18 C.F.R. Part 270

Natural gas
Price controls
Reporting and recordkeeping requirements

18 C.F.R. Part 284

Continental shelf
Natural gas
Reporting and recordkeeping requirements

In consideration of the foregoing, the Commission is amending Parts 270, and 284, Title 18, *Code of Federal Regulations* as set forth below.

By the Commission.

[SEAL]

/s/ Kenneth F. Plumb
KENNETH F. PLUMB,
Secretary.

[390] 44 U.S.C. §§ 3501-3520 (1982).

[391] 5 C.F.R. § 1320 (1986).

1. The authority citation for Part 270 continues to read as follows:

Authority: Natural Gas Act, 15 U.S.C. 717-717w (1982); Department of Energy Organization Act, 42 U.S.C. 7101-7352 (1982); E. O. 12,009, 3 C.F.R. 142 (1978); Natural Gas Policy Act of 1978, 15 U.S.C. 3301-3432 (1982).

2. Section 270.201 is amended by revising paragraphs (a), (b)(1)(i), (b)(3), (c)(2), (d), (e)(1), and (f)(3) to read as follows:

§ 270.210 Good faith negotiation procedures.

(a) *Applicability, definitions, and general rules.* (1) This section applies to requests for renegotiation of the price of old gas sold under an existing contract.

(2) For purposes of this section:

(i) "Old gas" means natural gas which, if sold, would be subject to a maximum lawful ceiling price under section 104 or 106(a) of the NGPA.

(ii)(A) "Existing contract" means a contract in effect on July 18, 1986, or an expired contract pursuant to which sales of natural gas are continuing on that date under the service obligation of a certificate of public convenience and necessity, that includes the sale of any old gas and provides authority for the first seller to collect a higher price upon establishment by the Commission of a higher maximum lawful price.

(B) An existing contract includes the sale of old gas if, on July 18, 1986, the contract encompasses the sale of any gas that has not been abandoned under section 7(b) of the Natural Gas Act and which, if sold, would be priced as old gas, whether or not any old gas is sold on that date.

(iii) The terms "first seller" and "party to a contract" include:

(A) an owner of a working interest in an oil or gas lease that has a direct contractual relationship with a purchaser for a "first sale" of gas, as defined in section 2(21) of the NGPA; and

(B) an operator of an oil or gas lease that has a direct contractual relationship with a purchaser for a "first sale" on behalf of any owner of a working interest in the lease that does not have such a relationship.

(3)(i) Any existing contract under which old gas is sold may be renegotiated or amended at any time to provide for a price up to the alternative maximum lawful price under § 271.402(c)(7)(i) of this chapter without using the good faith negotiation procedures.

(ii) A price for old gas that exceeds the otherwise applicable maximum lawful price under § 271.402 of this chapter may be collected under an existing contract only if the first seller and purchaser agree upon a price up to the alternative maximum lawful price under § 271.402 (c)(1)(ii) in accordance with this section.

(4) A party to an existing contract may not request a nomination of a price under the provisions of this section for any gas sold under the contract, if that party:

(i) and the purchaser or first seller have renegotiated the price or any other terms for the sale of any old gas under the contract after July 18, 1986, without using the good faith negotiation procedures, of this section, and have not agreed in writing to preserve their rights under this section;

(ii) has previously requested nomination of a price under paragraph (b)(1) of this section for any gas sold under the contract; or

(iii) has been requested under this section to nominate a price for any gas sold under the contract, and the last date has passed under paragraphs (b)(2) or (b)(3) of this section to request the other party to nominate a price for gas sold under the contract.

(5) Any request for nomination of a price under this section, any nomination of a price in response to such a request, and any notice of abandonment of sales or termination of purposes under this section must be sent by U.S. mail, return receipt requested.

(6) Any deadline under this section for requesting a nomination of a price, or for nominating a price in response to such a request, may be extended by mutual agreement of the parties in writing.

(7) A party nominating a price may propose a change in any other term of the existing contract, and for purposes of this section, the terms "nominated price" and "nomination" may include such a proposed change.

(b) *Requests for negotiation and nomination of price.*

(1)(i) At any time after (insert date 30 days after publication of this order in the *Federal Register*) a first seller may request the purchaser to nominate a price at which the purchaser is willing to continue buying old gas under any existing contract by submitting a written request to the purchaser, and may specify the wells or category of wells under each contract for which the first seller requests a renegotiated price.

* * * *

(3) Within 30 days after receiving a request from a purchaser for nomination of a price for any gas under a contract that is not named in the first seller's request and that includes the sale of any old gas, the first seller may request the purchaser to nominate a price at which the purchaser is willing to continue buying any old gas under that contract, including old gas for which the purchaser has requested a nomination of price by the first seller, by submitting a written request to the purchaser.

* * * *

(c) *No response to request for nomination.*

(1) * * *

(2) If the first seller does not nominate a price in writing within 60 days after receiving the purchaser's request for nomination of a price, the purchaser may terminate its purchases of all or part of the gas named in its request for nomination at any time upon 60 days written notice to the first seller.

(d) *Purchaser's nomination of highest price.* If the purchaser nominates in writing the highest price to which an existing contract price could escalate with the purchaser's agreement under § 271.402(c)(7)(ii) of this chapter, and the purchaser does not propose a change in any term of the contract, sales must continue at the nominated price under the terms of the existing contract.

(e) *Purchaser's nomination of lower price; first seller's options.* (1) If the purchaser nominates in writing a price less than the highest price to which the existing contract price could escalate or proposes a change in any other term of the contract, the first seller must accept or reject the nominated price in writing within 30 days after receiving the nomination. If the first seller does not accept the purchaser's nominated price in writing within 30 days, the nominated price is deemed rejected.

* * * *

(f) *First seller's nomination of price; purchaser's options.*

* * * *

(3) If the purchaser rejects the nominated price, the purchaser may at any time terminate its purchases of all or part of the gas named in its request for nomination upon 60-days written notice to the first seller.

* * * *

3. In section 270.201, the first sentence of paragraph (h) is amended by removing the phrase "is deemed to have agreed to" and inserting in lieu thereof the word "must".

4. The authority citation for Part 284 continues to read as follows:

Authority: Natural Gas Act, 15 U.S.C. 717-717w (1982); Natural Gas Policy Act of 1978, 15 U.S.C. 3301-3432 (1982); Department of Energy Organization Act, 42 U.S.C. 7107-7352 (1982); E. O. 12,009, 3 C.F.R. 142 (1978).

5. In section 284.225, paragraph (a) is amended by removing the phrase "is deemed to have agreed to" and inserting in lieu thereof the word "must".

6. The table of contents for Part 284 is amended by adding a new section to Subpart K to read as follows:

PART 284—CERTAIN SALES AND TRANSPORTATION OF NATURAL GAS UNDER THE NATURAL GAS POLICY OF 1978 AND RELATED AUTHORITIES

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SUBPART G—BLANKET CERTIFICATES AUTHORIZING CERTAIN TRANSPORTATION BY INTERSTATE PIPELINES ON BEHALF OF OTHERS AND SERVICE BY LOCAL DISTRIBUTION COMPANIES

Sec.

* * * *

284.226 **Transportation by interstate pipelines upstream of pipelines releasing gas under the good faith negotiation procedures**

7. Section 284.225 is amended by revising paragraph (d) to read as follows:

* * * *

§ 284.225 **Transportation by interstate pipelines of gas released under the good faith negotiation procedures.**

(d) *Transportation rates.*

(1) *Transportation service within contract demand.* If a pipeline provides transportation of gas to an existing

customer under this section and, as a result, the total volumes of gas sold and transported to that customer on a firm basis do not exceed existing firm contract demand by that customer, the pipeline:

(i) Must base its transportation rate for such gas on the rate in a transportation rate schedule on file with the Commission that conforms to § 284.7 and § 284.8(d);

(ii) must waise any transportation reservation fee to the extent that a customer pays for facilities associated with such transportation service through demand charges under its firm sales rate schedule;

(iii) must credit the volumes of gas transported against any minimum commodity bill obligation; and

(iv) may recover costs, on an Mcf or MMBtu basis, associated with standing by to serve a firm sales rate schedule customer that does not reduce its contract demand, if the pipeline revises its sales rate schedules on file with the Commission.

(2) *Transportation service in excess of contract demand.* If a pipeline provides transportation of gas to an existing customer under this section and, as a result, the total volumes of gas sold and transported to that customer exceed existing firm contract demand to that customer, the transportation rate for such gas must be the rate in a transportation rate schedule on file with the Commission that conforms to § 284.7 and either § 284.8-(d) for firm service or § 284.9(d) for interruptible service.

(3) *Transportation service for other customers.* If a pipeline provides transportation of gas under this section to any pipeline or customer other than an existing customer on a firm basis, the transportation rate for such gas must be the rate in a transportation rate schedule on file with the Commission that conforms to § 284.7 and either § 284.8(d) for firm service or § 284.9(d) for interruptible service.

(4) *Interim rates.* If a pipeline does not have a transportation rate schedule on file with the Commission that conforms to § 284.7 and either § 284.8(d) for firm service of § 284.9(d) for interruptible service, the pipeline must file such a rate schedule within 60 days after first providing transportation service under this section. Until such a rate schedule becomes effective, the pipeline must provide the transportation service using the rate in one of the pipeline's transportation rate schedules on file with the Commission which the pipeline determines covers service comparable to transportation service authorized under this section.

* * * *

8. Part 284 is amended by adding a new § 284.226 to read as follows:

284.226 Transportation by interstate pipelines upstream of pipelines releasing gas under the good faith negotiation procedures

(a) *Applicability.* This section applies to any upstream interstate pipeline that is not subject to the nondiscriminatory access provisions of § 284.8(b) or § 284.9 (b) of this chapter and that provided transportation of gas immediately prior to its release by any interstate pipeline due to termination or abandonment under the good faith negotiation procedures in § 270.201 of this chapter. Such upstream pipelines were those authorized under a certificate of public convenience and necessity to transport natural gas, prior to the release of that gas due to termination or abandonment under § 270.20(c), (e), or (f) of this chapter, along any line between the wellhead and a pipeline that must transport the gas under § 270.201(h) of this chapter.

(b) *Blanket Certificate.* Such upstream interstate pipelines are granted a blanket certificate of public convenience and necessity that authorizes transportation of natural gas released due to termination or abandonment under § 270.201(c), (e) or (f) of this chapter on

behalf of any shipper to any interstate pipeline releasing gas under § 270.201 of this chapter, under the same terms and conditions as previously provided to the releasing pipeline.

(c) *Transportation rates.* The rates charged by such third-party, upstream pipelines for transportation under this section shall be identical to the rates charged under any pre-existing transportation authorization for the same service previously provided to the releasing pipeline.

(d) *Reporting requirements.* An interstate pipeline that transports gas under the certificate granted by this section is subject to the reporting requirements of § 284.223(f).

FERC ORDER 451-B

52 F.R. 21669 (June 9, 1987).

18 CFR Parts 270 and 284

[Docket Nos. RM86-3-069—077; Order No. 451-B]

Ceiling Prices; Old Gas Pricing Structure

Issued June 3, 1987.

AGENCY: Federal Energy Regulatory Commission, DOE.

ACTION: Order Granting Rehearing in Part, Denying Rehearing in Part, Clarifying Final Rule, and Denying Stay Request.

SUMMARY: The Federal Energy Regulatory Commission is granting in part and denying in part rehearing of, and clarifying, Order No. 451-A which amended Order No. 451. The final rule adopted in those orders established a new alternative ceiling price for old gas priced under sections 104 and 106 of the Natural Gas Policy Act of 1978. The final rule also established a "good faith" negotiation rule" with which producers must comply before collecting a higher price under an existing contract, absent voluntary renegotiation of the contract. In addition, the final rule provided blanket transportation certificates to non-Order No. 436 interstate pipelines which formerly purchased, or provided upstream transportation of, gas released under the good faith negotiation rule in order to facilitate marketing of that gas to a new purchaser. On rehearing of Order No. 451-A, the Commission amends the regulations implementing the good faith negotiation rule to clarify the effect of assignments on the parties' rights under that rule and to permit first sellers and purchasers to mutually agree to shorten the notice which must be given before sales or purchases are abandoned or terminated. The Commission also grants intra-

state pipelines a limited jurisdiction certificate to perform the same transportation which Order Nos. 451 and 451-A authorize or require non-Order No. 436 interstate pipelines to perform. Finally, the Commission denies the request of Williams Natural Gas Company for a stay of Order Nos. 451 and 451-A.

EFFECTIVE DATE: The amendments to the Commission's regulations adopted in this order shall become effective on June 3, 1987, except that §§ 284.225(f)(4) and (g) and 284.226(d) shall not become effective until July 9, 1987.

SUPPLEMENTARY INFORMATION:

Order Granting Rehearing in Part, Denying Rehearing in Part, Clarifying Final Rule, and Denying Stay Request

Before Commissioners: Martha O. Hesse, Chairman; Anthony G. Sousa, Charles G. Stalon, Charles A. Trabandt and C.M. Naeve.

I. Introduction

On December 15, 1986, the Commission issued Order No. 451-A[1] amending the final rule adopted in Order No. 451.[2] That final rule modified the price structure of old natural gas and established regulations governing implementation of the revised price structure. The Commission has received three timely applications for rehearing or clarification of Order No. 451-A, and five requests for reconsideration.[3] This order grants in part and denies in

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[1] 51 FR 46762 (December 24, 1986).

[2] 51 FR 22168 (June 18, 1986).

[3] Meridian Oil, RM86-3-069, January 14, 1987; Independent Petroleum Association of America (IPAA), RM86-3-070, January 14, 1987; General Service Customer Group (GSC), RM86-3-071, January 14, 1987. On April 13, 1987 Williams Natural Gas Company

part rehearing of, and clarifies, Order No. 451-A. It also denies a request by Williams Natural Gas Co. that the Commission stay Order Nos. 451 and 451-A pending judicial review.

II. Background

In order No. 451, the Commission established a new, alternative ceiling price for old gas priced under sections 104 and 106 of the Natural Gas Policy Act of 1978 (NGPA).[4] That ceiling price is equal to the existing ceiling price for post-1974 old gas. In order to prevent indefinite price escalation clauses from automatically raising prices to the new ceiling price regardless of the market price, and in order to provide balanced negotiating rights among the parties, the Commission required that parties to existing contracts, who do not voluntarily negotiate a new or amended contract price, comply with a "good faith negotiation rule" before collecting higher prices. That rule establishes a three-step procedure by which contracts are placed on the bargaining table.

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filed a motion for reconsideration of Order No. 451-A. Panhandle Eastern Pipe Line Co. (Panhandle) and Trunkline Gas Co. (Trunkline) filed a joint motion for reconsideration on April 23, 1987.

On February 5, 9, and 19, 1987, respectively, Texaco Inc., Arco Oil and Gas Co., and Conoco, Inc., filed "comments" on IPAA's request for rehearing generally supporting that request on the assignment issue. On March 16, 1987 Columbia Gas Transmission Corp. (Columbia) filed comments opposing IPAA's request for rehearing. On March 31, 1987 Amoco Production Company (Amoco) filed a response to Columbia's filing.

The Commission's procedural regulations do not permit answers to rehearing requests. 18 CFR 385.713(d)(1) (1986). However, the Commission will treat Texaco, Arco, and Conoco's comments as requests for reconsideration of Order No. 451-A since those comments seek changes in Order No. 451-A. Columbia's comments, which do not seek changes in Order No. 451-A, are rejected and will not be considered in this order. It follows that Amoco's response to Columbia's comments must also be rejected.

[4] 15 U.S.C. 3314 and 3316 (1982).

In step 1, a producer may request the purchaser to nominate a new price for any old gas sold under existing contracts which authorize a higher price. In step 2, the purchaser may request that the producer nominate a new price for any old or other gas sold by the producer under contracts covered by the producer's request. In addition, the purchaser may request the producer to nominate a new price for any gas sold by the producer under any other existing contract between the parties which contains some old gas. In step 3, the producer may request the purchaser to nominate a new price for its old gas in the contracts brought to the negotiating table by the purchaser in step 2. If the parties agree to a new price, sales continue under the existing contract at the agreed upon price. If the parties do not agree, the party that requested nomination of a price may cease sales or purchases of the gas covered by the nomination request and abandonment is deemed granted. Whenever gas previously sold to a non-Order No. 436 pipeline is eligible for release under the good faith negotiation rule, the producer must give the pipeline's firm sales customers a right of first refusal before selling released jurisdictional gas to a third party. Non-Order No. 436 interstate pipelines which formerly purchased released gas must transport that gas to their existing customers or to interconnecting pipelines. The Commission granted a blanket certificate for the performance of such transportation.

In Order No. 451-A, the Commission generally denied rehearing of Order No. 451. However, the Commission did modify the regulations governing the rates charged by non-Order No. 436 pipelines for transportation performed under the rule in order to assure that those rates are the same as those for comparable transportation under Order No. 436. The Commission also authorized non-Order 436 interstate pipelines, which provided transportation of released gas upstream of the releasing pipeline immediately before the release, to continue the transportation on behalf of any shipper. Finally, the Commission clarified the

operation of the good faith negotiation rule in various respects and made several minor modifications in the regulations implementing that rule. The applications for rehearing of Order No. 451-A raise a number of issues concerning the good faith negotiation rule and the transportation provisions of the final rule as modified in Order No. 451-A.

III. Discussion

1. The first, and perhaps most significant, issue raised concerns the operation of the good faith negotiation rule when a producer has assigned gas to another producer subject to an existing sales contract. On rehearing of Order No. 451, some rehearing applicants expressed concern that producers might seek to avoid renegotiation of their new gas in multi-vintage contracts in step 2 of the nominating process by transferring or assigning their old or their new gas to another entity so that all new and old gas is in separate contracts. The Commission stated that this was not a significant danger under the rule as adopted. As explained in the Order No. 451-A preamble:

> Mere assignment to another corporate entity of old or new gas covered by a multi-vintage contract without amendment of the sales contract itself could not insulate the new gas from renegotiation in step 2. This is because the original owner of the gas would still appear on the contract with the purchaser as the seller of that gas. The purchaser is entitled to obtain renegotiation in step 2 of all gas sold under the contract as it was on July 18, 1986, by the seller regardless of whether the seller claims someone else owns the gas.[5]

IPAA, Texaco, Conoco, and Arco assert that this statement is inconsistent with state law. Once an assignment has occurred, the assignor has no further legal authority to negotiate on behalf of the assignee. Thus, if a pro-

[5] 51 FR at 46,795-796.

ducer assigned its new gas to another producer and thereafter requested the purchaser to nominate a new price for its old gas, any request by the purchaser in step 2 that the assignor nominate a price for the new gas would be futile since that producer no longer has legal authority to negotiate the price of that gas.

IPAA suggests that, consistent with state law, the Commission modify the definition of "first seller" and "party to a contract," set forth in § 270.201(a)(2)(iii), to include only persons having a direct contractual relationship with the purchaser as of the date a nomination request is made. The effect of such a provision, in the absence of any other change in the regulations implementing the good faith negotiation rule, would be that when an assignor or assignee makes a nomination request in step 1, the purchaser in step 2 could only seek negotiation of gas currently sold it by that assignor or assignee. This is because the regulations currently permit the purchaser to seek renegotiation in step 2 only of gas sold it by the "first seller" who made the nomination request in step 1.

Texaco, Conoco, and Arco agree with IPAA that a purchaser should be permitted in step 2 to seek renegotiation only of gas currently sold it by the assignor or assignee initiating good faith negotiation at least where the assignor and assignee are not affiliated. They state that there is little danger that producers will significantly circumvent purchasers' step 2 rights through assignment except possibly where producers are affiliated. Too many other considerations are involved when producers assign gas leases for them to manipulate such assignments for purposes of circumvention. Texaco also states that producers lack any incentive to try to circumvent the purchasers' step 2 rights, since, as the Commission stated in Order No. 451, the price of high-cost new gas will be forced downward as a result of higher prices for old gas even apart from the purchaser's rights in step 2.

Furthermore, Texaco, Conoco, and Arco contend that permitting the purchaser to renegotiate both the assignor's and assignee's multi-vintage gas when only one of them initiates good faith negotiation could be unfair to some producers. For example, an assignor who assigned old gas in one contract for legitimate business reasons could find all its multi-vintage contracts subject to good faith negotiation solely because of the actions of the assignee, even though the assignor desired to forego good faith negotiation.[6] Texaco states that, in order to avoid this possibility, it has begun requiring persons to whom it makes assignments to waive any rights to initiate good faith negotiation with respect to the assigned gas as a condition of the assignment. While Texaco, Conoco, and Arco agree with IPAA that a purchaser in step 2 should be limited to seeking renegotiation only of gas currently sold it by the assignor or assignee initiating good faith negotiation, they contend that that result can be achieved under the existing regulations and that there is no need for the amendment suggested by IPAA. They also state that, if the Commission desires to prevent circumvention by affiliates, it should adopt a regulation addressing that specific problem.

The Commission agrees with Texaco that, over the long term, any attempt through an assignment to insulate high-cost gas from renegotitaion downward is likely to prove futile. As discussed in detail in Order No. 451,[7] the Commission expects new gas prices to be renegotiated downward as a result of the market forces released under this rule, apart from the rights granted purchasers in step 2. However, the Commission nevertheless found the purchaser's step 2 rights necessary to assure that in the short term there is no lag between

[6] Similarly, the gas assigned to the assignee could likewise become subject to renegotiation solely because the assignor initiated good faith negotiation.

[7] 51 FR at 22196-198.

the producer's obtaining a higher price for old gas and the purchaser's obtaining lower prices for new gas sold in multi-vintage contracts.[8] The Commission desires to minimize any possible circumvention of this assurance by producers through assignments. The danger of circumvention is not limited to assignments among affiliates, as suggested by Texaco, Conoco, and Arco. For example, a producer who owned mostly new gas and therefore did not desire to initiate good faith negotiation might sell its old gas in a multi-vintage contract to a second, unaffiliated producer for a price based upon the value of the gas when sold subject to the alternative ceiling price. When the second producer initiated good faith negotiation for the assigned gas, the purchaser would not be able to make a nomination request in step 2 for the unassigned new gas. Accordingly, the Commission does not adopt the rehearing applicants' proposal.

However, the Commission is sympathetic with the concern of Texaco, Conoco, and Arco that permitting the purchaser in step 2 to make nomination requests with respect to all gas which would have been eligible for renegotiation in the absence of the assignment—the approach suggested in the Order No. 451-A preamble—could be unfair to some producers. As stated by the rehearing applicants, only the assignee has power to contract with respect to the assigned gas, just as only the assignor has power to contract with respect to the unassigned gas.[9] Therefore, in order to implement the approach suggested in the Order No. 451-A preamble, the purchaser would have to be given the right, when an assignor or its assignee initiates good faith negotiation, to request the other to nominate a price for any gas

[8] Order No. 451-A, 51 FR at 46,788-789.

[9] In general when a producer assigns gas to another producer, the assignee succeeds to all the rights and obligations of the assignor with respect to the assigned gas. *See* 4 Williams, Oil & Gas Law § 735 (1985).

which would have been subject to good faith negotiation in the absence of the assignment. This would mean that an assignor or assignee who did not desire to engage in good faith negotiation could nevertheless be drawn into such negotiation as a result of the nomination request of the other. This could have a particularly adverse effect on assignors, all of whose multi-vintage contracts would become subject to good faith negotiation as a result of a nomination request by the assignee.

For these reasons, the Commission is modifying Order No. 451-A with respect to assignments (or other transfers that in substance yield the same effect) on or after the issuance of this order as follows. A producer who validly assigns gas subject to a contract existing on July 18, 1986 which included old gas will be ineligible to initiate good faith negotiation for any gas it sold to the purchaser unless the purchaser in step 2 can renegotiate all the gas which would have been subject to renegotiation in the absence of the assignment. The same rule will also apply to the assignee; however, its ineligibility to initiate good faith negotiation will be limited to the assigned gas.[10] The purchaser's ability to renegotiate the gas which would have been subject to renegotiation in the absence of the assignment could arise, for example, through an agreement by the assignor or assignee to permit renegotiation of its gas if the other initiates good faith negotiation or through the assignment itself under state law. This rule will protect purchasers from circumvention of their step 2 rights as a result of assign-

[10] The assignee's ineligibility need not extend to the gas it sells under its own contracts with the purchaser in order to prevent circumvention of the purchaser's step 2 rights. If there had been no assignment and the assignor had requested the purchaser to nominate a price for the assigned gas, the purchaser would not have been entitled in step 2 to reach the assignee's gas. The purchaser could only reach that gas if the assignee makes a nomination request for some of its gas, and in such circumstances the purchaser can reach that gas in step 2 after the assignment as well as before.

ments after the issuance of this order, without requiring any producers involuntarily to renegotiate their gas except where state law permits purchasers to require such renegotiation.

The Commission will not apply the above described rule to assignments before the issuance of this order. In its interim order on rehearing issued July 18, 1986, the Commission stated that it would only change its regulations governing eligibility to initiate good faith negotiation prospectively. Those regulations, as in effect before issuance of this order, permitted producers to make assignments without potential loss of eligibility to initiate good faith negotiation.[11] It would be unfair to deprive a producer of its eligibility for good faith negotiation because of an assignment made when the Commission had given no notice that assignments could cause such a loss of eligibility. However, as stated above, the Commission believes that the rule suggested by the Order No. 451-A preamble is also unfair. Accordingly, the Commission has determined not to apply that rule to assignments before the issuance of this order either. Rather, this order provides that, when gas in an existing contract including old gas has been assigned before the issuance of this order, the purchaser in step 2 may seek renegotiation of any multi-vintage or old gas currently sold by the assignor or assignee initiating good faith negotiation, but not any other gas. Accordingly, assigned gas shall be subject to renegotiation in step 2 only when the assignee initiates good faith negotiation for old gas in any of its contracts with the purchaser. Similarly, the unassigned gas will be subject to renego-

[11] *See* Order No. 451-A, 51 FR at 46796, in which the Commission raised the possibility of loss of eligibility for good faith negotiation as a result of an assignment only if the producer and the purchaser actually amended the sales contract to name the assignee as a seller.

tiation in step 2 only when the assignor initiates good faith negotiation.[12]

Furthermore, the Commission believes that any impact on purchasers as a result of some above-market gas not being subject to renegotiation in step 2 through application of the above described rule will often be counterbalanced by other high-cost gas becoming subject to renegotiation which otherwise would not have been. For example, a producer who does not intend to initiate good faith negotiation may, for legitimate business reasons, have assigned high-cost gas to another producer who owns a large amount of old gas and will initiate good faith negotiation. As a result the purchaser will now have an opportunity to renegotiate that gas in step 2 which it would not have had without the assignment.[13] Finally, even when high-cost gas is not subject to renegotiation in step 2 as a result of an assignment before issuance of this order, the competitive forces in the natural gas market released by this rule should enable the purchaser to renegotiate that gas downward. The Commission concludes that the rule adopted here governing assignments before the date of this order provides the best method of handling such assignment, since these rules should not result in significant circumvention of the purchaser's step 2 rights and the identified alternatives as discussed could have an unfair impact.

[12] This result is reached through application of the existing regulations governing the purchaser's step 2 rights. Under § 270.201 (b)(2) the purchaser may make a nomination request in step 2 only to the "first seller" initiating good faith negotiation. That "first seller" under § 270.201(b)(2) is the assignor or assignee initiating good faith negotiation.

[13] It should be observed that no assignment after July 18, 1986 of the old or new gas in a multi-vintage contract can alter the fact that the new gas is sold under a multi-vintage contract including the sale of old gas. Pursuant to § 270.201(a)(2)(ii)(B), a contract includes the sale of old gas if on July 18, 1986 it encompassed the sale of such gas.

The Commission is also amending the regulations governing good faith negotiation so as to authorize the purchaser, when gas is assigned after the issuance of this order and the assignor or assignee is eligible to initiate good faith negotiation,[14] to renegotiate in step 2 all gas which would have been subject to renegotiation in the absence of the assignment. This amendment is necessary, since the current regulations do not specifically authorize the purchaser, in any circumstances when an assignee or assignor initiates food faith negotiation, to request the other to nominate a price for its gas. When a producer who assigned gas after the issuance of this order initiates good faith negotiation for gas sold under the contract which includes the assigned gas or sold under another contract, the amended regulations authorize the purchaser in step 2 to request the assignee to nominate a new price for the assigned gas. The purchaser may also request the assignor to nominate a new price for any unassigned gas in the assignor's multi-vintage contracts with the purchaser which contain some old gas. If the assignee initiates good faith negotiation, the purchaser may request in step 2 that the assignor nominate a new price for any unassigned gas in any of its multi-vintage contracts with the purchaser. The purchaser also may request that the assignee nominate a new price for the assigned gas. However, the purchaser may not request the assignee to nominate a new price for any other gas sold under contracts between the purchaser and the assignee. The purchaser could not have reached that gas if the assignment had never occurred and the assignor had initiated good faith negotiation.[15] These procedures

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[14] As discussed above, the assignor or assignee would be eligible to initiate good faith negotiation if the other agrees that the purchaser may renegotiate its gas in step 2, state law permits the purchaser to do so, or for some other reason the purchaser must be given such a right.

[15] For the same reasons, if the assignee requests the purchaser to nominate a price for gas sold under its own contracts with the

are designed only to give the purchaser the same rights it would have had in the absence of an assignment, not to expand those rights.

While in the circumstances described above, when an assignor or assignee initiates good faith negotiation, the purchaser may make nomination requests to the other, the assignor and assignee are still considered separate first sellers and parties to the contract for purposes of the good faith negotiation rule. Thus, when the purchaser makes nomination requests to both, each must nominate a price for its gas and the purchaser may accept the nomination of one and reject the nomination of the other as it chooses although, consistent with the rules governing good faith negotiation generally, the purchaser cannot partially accept or reject the nomination of a particular assignor or assignee. Furthermore, if an assignor or assignee initiates good faith negotiation and the purchaser does not exercise its right to request the other to nominate a price, then the negotiation between the party initiating good faith negotiation and the purchaser will not affect the other's right subsequently to initiate good faith negotiation. An assignor or assignee loses its right subsequently to initiate good faith negotiation only if its gas is placed on the bargaining table.[16] Of course, if the purchaser does request the other to nominate a price, the assignor or assignee must make any nomination request it desires in step 3. This is consistent with the general rule governing signatory working interest owners' loss of the right to initiate good faith negotiation. *See* Order No. 451-A, 51 FR at 46801.

2. Williams Natural Gas Company (Williams) requests that the Commission expand purchasers' step 2 rights to permit purchasers to seek lower prices for new

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purchaser, the purchaser may not request the assignee in step 2 to nominate a price for the assigned gas.

[16] See 18 CFR 270.201(a)(4).

gas covered by any contract between the parties, regardless of whether that contract includes old gas. Williams states that this change in Order Nos. 451 and 451-A is necessary because of the decision of the Tenth Circuit Court of Appeals in *Martin Exploration Management Co. v. FERC*[17] In that case, the court reversed the Commission's holding in Order No. 406[18] that, when gas has been determined to qualify for both a deregulated gas category and a regulated category, the gas is deemed deregulated. Among the categories of gas which were deemed price-deregulated under Order No. 406 was certain gas qualifying under NGPA section 107(c)(5) as new tight formation gas. Order No. 406 thus permitted many purchasers to pay less than the relatively high section 107(c)(5) ceiling price for that gas through, for example, contract clauses providing for price redetermination upon deregulation. Williams alleges that the reversal of Order No. 406 means that producers with indefinite price escalation clauses will now again be eligible to receive the section 107(c)(5) ceiling price, currently $6.36. This could significantly increase pipelines' cost of gas. Williams states that expansion of purchasers' step 2 renegotiation rights will give pipelines an opportunity to mitigate the effect of *Martin*.

The Commission does not adopt Williams' proposal. The reasons the Commission gave in Order No. 451-A for refusing to permit purchasers in step 2 to renegotiate new gas not in multi-vintage contracts are as valid after *Martin* as before. As the Commission stated in Order No. 451-A, the competitive forces in the natural gas market, which will be strengthened by the increased production and more accurate price signals resulting from this rule, will over time force down new gas prices wholly

[17] Case No. 84-2756, *et al.*, decided March 9, 1987.

[18] Deregulation and Other Pricing Changes on January 1, 1985, Under the Natural Gas Policy Act, 49 FR 46874 (Nov. 29, 1984).

apart from the good faith negotiation rule.[19] Thus, it is unnecessary to expand the purchasers' step 2 rights in order to enable them to bring down the price of new gas, including section 107(c)(5) gas. Furthermore, permitting the purchaser to renegotiate all new gas would increase the potential cost to many producers of initiating good faith negotiation, with the result that fewer producers would do so. This would seriously impede achievement of the Commission's goal of market responsive prices for old gas so as to avoid premature abandonment of that gas. Therefore, the Commission continues to believe that a proper balance between the need for higher prices for old gas and fairness to purchasers is achieved by permitting purchasers to renegotiate in step 2 only new gas sold in multi-vintage contracts. This assures that there is no lag between the producer's obtaining a higher price for old gas and the purchaser's obtaining a lower price for new gas sold under multi-vintage contracts, thereby avoiding disruption of the mutuality of consideration in multi-vintage contracts in which all terms are interrelated. At the same time, however, it avoids making good faith negotiation so costly that few producers initiate it.

3. Meridian observes that some multi-vintage contracts may provide no authority for a higher price for the old gas and yet also contain high-priced new gas. An example would be a contract containing only minimum rate old gas and deregulated new gas. Meridian requests clarification whether the producer may request a price nomination for the old gas in such a contract in step 3, if the purchaser requests a price nomination for the new gas in step 2. The situation posed by Meridian cannot arise because the purchaser could not make a nomination request with respect to the contract in question in step 2. Section 270.201(b)(2) only authorizes the purchaser to make nomination requests in step 2

[19] 51 FR at 46790-791.

with respect to "any existing contract with the purchaser that includes the sale of any old gas." Section 270.201(a)(2)(ii)(A) defines "existing contract" as a contract in effect on July 18, 1986 "that . . . provides authority for the first seller to collect a higher price upon establishment by the Commission of a higher maximum lawful price." Thus, the only multi-vintage contracts which the purchaser in step 2 can bring to the bargaining table are those which permit a higher price for at least some of the old gas in the contract. Of course, where the purchaser in step 2 requests the producer to nominate a price for new gas in a multi-vintage contract providing authority for a higher price for some but not all of the old gas in the contract, the producer in step 3 could only request the purchaser to nominate a price for the old gas for which there was authority for a higher price.

4. A producer must enter into a contract to sell to a third party and give the purchaser 30 days' notice before terminating sales under the good faith negotiation rule. IPAA requests that the Commission clarify that, where a producer must comply with the Order No. 451 right of first refusal, it may give the 30 days' notice to the pipeline as soon as it has obtained an offer substantially accepted in principle from the non-firm sales customer, rather than waiting until it has executed a contract with either the non-firm sales customer or a firm sales customer exercising its right of first refusal. Permitting the 30-day notice period to run concurrently with the presentation of a third-party offer to the pipeline's firm sales customer allegedly would further the policy objectives of Order No. 451 by permitting released or abandoned gas to be sold to alternative purchasers at market-responsive prices more quickly. It would also make third parties more willing to purchase released gas since deliveries could start more quickly after the agreement in principle with the producer. Finally, because some pipelines require transportation to begin within a certain

period of the signing of the transportation agreement, arrangement of transportation to the new purchaser would be easier.

The Commission rejects IPAA's proposed clarification. In Order No. 451-A, the Commission clearly stated its intent that the producer must execute a contract with the new purchaser before giving the existing purchaser the 30 days' notice of termination of sales.[20] When the producer must give the firm sales customers a right of first refusal of an offer accepted by a non-firm sales customer, no contract can be executed until after the offer has been presented to the firm sales customers. Accordingly, the 30 days' notice cannot be given until after the right of first refusal has been complied with. Without the requirement of an executed contract before the producer gives the 30 days' notice, there would be a possibility that upon completion of the 30-day notice period the producer still would not have executed a contract to sell the gas to another purchaser and thus would not qualify for the abandonment granted under the good faith negotiation rule.[21] It would be difficult for the purchaser to contract to purchase replacement supplies from another producer if it could not be certain that upon completion of the 30-day notice period sales by the first producer

[20] 51 FR at 46784.

[21] Even if the producer had presented a third-party offer to firm sales customers concurrently with giving the 30 days' notice so that the 20-day period for responding to the third party offer would expire before the 30 days' notice, there could be no certainty that a sales contract would actually be executed with a new purchaser before the end of the 30-day notice period. If all the firm sales customers rejected the third-party offer, the deal between the producer and the non-firm sales customer might still fall through, requiring the producer to start all over again looking for a new purchaser and comply with the right of first refusal a second time if the next potential purchaser is a non-firm sales customer. If more than one firm sales customer accepted the offer, it might take beyond the 30 days' notice period for the producer to choose to which one to sell and execute a contract.

would be abandoned. Avoiding any uncertainty over whether the abandonment will occur at the end of the 30-day notice period justifies any additional delay in the commencement of sales to the new purchaser. Such additional delay would in no event be more than the 30-day notice period. With regard to IPAA's concern about pipeline requirements that transportation service begin within a certain period after it is arranged, the Commission observes that operational conditions imposed on any transportation service required by Order No. 451 must be reasonable and not unduly discriminatory or preferential. Such operational conditions may not be imposed in order to avoid the Order No. 451 transportation obligation.

5. Purchasers must give the first seller 60 days' notice before abandoning or terminating purchases under the good faith negotiation rule. Panhandle and Trunkline request that the Commission provide that the first seller and purchaser may mutually agree to shorten this 60-day notice period. The Commission established the 60-day notice period in order to give the first seller a reasonable opportunity to arrange sales to an alternative purchaser.[22] Since the 60-day notice period is for the protection of the first seller ,there appears no reason not to permit the first seller to waive that notice through a mutual agreement with the purchaser. In addition, such a shortening of the notice period would permit the Commission's goal of more market-responsive pricing to be achieved more quickly for the gas in question. The Commission believes that the same reasoning also supports permitting the first seller to abandon or terminate sales under the good faith negotiation rule upon less than the required 30 days' notice when the parties mutually so agree. Accordingly, the Commission is modifying its regulations to permit the parties to mutually agree to shorten the notice period for termination or abandonment of both sales and purchases.

[22] Order No. 451-A, 51 FR at 46799.

6. In Order No. 451-A, the Commission stated that a firm sales customer's Order No. 451 right of first refusal and a non-Order No. 436 pipeline's NGPA section 315(b) right to a bona fide offer and right of first refusal [23] could never arise simultantously with respect to the same gas. The Order No. 451 right of first refusal only applies to non-jurisdictional gas such as that covered by section 315(b) if it is packaged with jurisdictional gas. The Commission stated that a producer may not package gas covered by section 315(b) with other gas when giving the original purchaser its section 315(b) rights. Accordingly, the gas covered by section 315(b) will never be available for packaging with released jurisdictional gas for purposes of the Order No. 451 right of first refusal. IPAA questions whether the Commission's section 315(b) regulations prohibit the packaging of 315(b) gas with other gas. Accordingly, it suggests that under the Commission's current regulations producers may be required with respect to the same gas both to give the original purchaser its section 315(b) rights and to give the firm sales customers a right of first refusal under Order No. 451. It proposes that the Commission solve this problem by amending its section 315(b) regulations to provide that a producer's compliance with the Order No. 451 right of first refusal extinguishes the original purchaser's section 315(b) rights.

The Commission rejects IPAA's proposal. First, that proposal would violate section 315(b) by depriving the original purchaser of its right under that section to receive a bona fide offer and right of first refusal. Second, IPAA is incorrect in suggesting that a producer may package gas covered by section 315(b) with other gas

[23] Section 315(b) requires that when a contract for the sale of NGPA section 102(c), 103(c), or 107(c)(1)-(4) gas which was subject to the Commission's Natural Gas Act (NGA) jurisdiction on the day before enactment of the NGPA expires or is terminated, the seller must give the existing purchaser a bona fide offer and right of first refusal before selling that gas to a third party.

when giving the original purchaser its section 315(b) rights. Section 315(b) requires that the producer give the original purchaser a bona fide offer and right of first refusal with respect to the gas covered by that section. Inclusion of other gas in the offer presented to the original purchaser would mean that the offer was not an offer to continue sales of the gas covered by section 315(b), but an offer only to sell a larger package of gas. Furthermore, permitting the producer to include other gas in the offer would allow it to circumvent the original purchaser's section 315(b) rights by including a large amount of other gas for which the purchaser had no need. As explained in Order No. 451-A,[24] since the non-jurisdictional gas covered by section 315 cannot be packaged with the jurisdictional gas covered by the Order No. 451 right of first refusal for purposes of giving the original purchaser its section 315(b) rights, there can be no overlay between the section 315(b) and the Order No. 451 rights of first refusal.

7. NGPA section 315(a) requires the Commission to prescribe a rule providing that contracts for the first sale of Outer Continental Shelf gas qualifying under NGPA sections 102(b) or 107(c)(1)-(4) be for a duration of not less than 15 years. IPAA requests that the Commission modify 18 CFR 277.101, adopted pursuant to section 315(a), so as to exclude from the 15-year duration requirement contracts for the sale of the relevant Outer Continental Shelf gas where that gas has been released under the good faith negotiation rule. Adoption of the proposed modification would violate section 315(a)'s requirement that contracts for the sale of all section 102(b) or 107(c)(1)-(4) Outer Continental Shelf gas be for a term of at least 15 years. Accordingly, the Commission cannot modify its regulations as proposed.

8. IPAA requests that the Commission modify the non-discriminatory access provision imposed on intra-

[24] 51 FR at 46805.

state pipelines performing transportation under NGPA section 311(a)(2) by Order No. 436[25] so as to permit intrastate pipelines to transport gas released under the good faith negotiation rule without being subject to the nondiscriminatory access provision. IPAA argues that such a modification is necessary to permit intrastate pipelines unwilling to become open access pipelines to transport gas released under the good faith negotiation rule and would be analogous to the transportation authorizations provided non-Order No. 436 interstate pipelines in Order Nos. 451 and 451-A.

The Commission agrees that, to the extent intrastate pipelines require Commission authorization to transport gas, those pipelines should be authorized to perform transportation analogous to that which Order Nos. 451 and 451-A authorize or require non-Order No. 436 interstate pipelines to perform. The same policy considerations supporting the transportation authorization for non-Order No. 436 interstate pipelines also apply in the case of intrastate pipelines. In order for the potential benefits of this rule to be realized in terms of both supply and price response, producers must be able to market released gas. Some producer's ability to market released gas could be hindered when an intrastate pipeline unwilling to become subject to the non-discriminatory access provisions of Order No. 436 refuses to perform section 311(a)(2) transportation. Accordingly, the Commission shall provide blanket "limited jurisdiction" section 7(c) certificates authorizing intrastate pipelines which either purchased, or provided upstream transportation of, released gas immediately before its release to transport that gas on behalf of either interstate pipelines or local distribution companies served by interstate pipelines. All transportation under these certificates shall be voluntary.

[25] 18 CFR 284.9(b). Under section 311(a)(2), the Commission may authorize intrastate pipelines to transport gas on behalf of interstate pipelines or local distribution companies served by interstate pipelines.

As we stated in Order 451-A with respect to upstream interstate pipelines, any intrastate pipeline electing to provide transportation under this authorization must do so in a not unduly discriminatory manner. *See* 51 FR at 46809.

The rate charged by an intrastate pipeline for transportation of released gas which the pipeline purchased immediately before the gas's release shall be determined pursuant to § 284.123(b). This assures that the rate shall be the same as if the transportation were provided under section 311(a)(2). The rate charged by an intrastate pipeline for upstream transportation of released gas shall be identical to the rate charged for the same service previously provided to the releasing pipeline.

9. The Order No. 451 transportation obligation and the Order No. 451 right of first refusal apply only to non-Order No. 436 interstate pipelines and the firm sales customers of such pipelines respectively. Order No. 451 defines non-Order No. 436 pielines as pipelines not subject to the non-discriminatory access provisions of § 284.8(b) and § 284.9(b). Pipelines performing section 311 transportation on an interim basis [26] are subject to these non-discriminatory provisions [27] and accordingly are considered Order No. 436 pipelines for purposes of Order No. 451. GSC and IPAA assert that this means such pipelines could nullify their customers' ability to obtain alternative supplies through the Order No. 451 right of first refusal and transportation provisions by going through good faith negotiation while still an Order No.

[26] The Commission has authorized certain pipelines to continue transportation under section 311 without becoming subject to the contract-demand reduction and conversion rights in section 284.10 until 30 days after the Commission issues the first order on rehearing of the individual pipeline's pending Order No. 436 settlement or blanket certificate. *See Texas Eastern Transmission Corp.*, 39 FERC ¶ 61,027 (1987).

[27] *Texas Eastern Gas Pipeline Co.*, 33 FERC ¶ 61,159 (1985).

436 pipeline performing interim section 311 transportation but thereafter ceasing the interim transportation. The pipeline could then refuse to transport any gas to the customers not purchased from the pipeline. GSC suggests that the Commission solve this problem by expanding the definition of non-Order No. 436 pipelines to include all pipelines who have not been granted and accepted an Order No. 436 blanket certificate under § 284.221 of the Commission's regulations. IPAA suggests alternatively that the Commission require that an Order No. 436 pipeline certify that it will remain such for at least 12 months. In the absence of such certification the Order No. 451 transportation obligation would apply to such pipelines.

The Commission refuses to modify Order No. 451's definition of non-Order No. 436 pipelines or to adopt IPAA's alternative suggestion. So long as a pipeline is subject to the non-discriminatory access provisions of Order No. 436, there is no reason to require it to transport gas under Order No. 451 or to give the pipeline's firm sales customers a right of first refusal. Transportation is already available under the non-discriminatory access provisions, thus permitting customers to purchase alternative supplies from any source and have that gas transported to them. It is true that pipelines may terminate the performance of interim section 311 transportation at any time and must do so when certain Order No. 436 filings have been processed. Nevertheless, the Commission does not believe that this fact will enable pipelines to prevent their customers from purchasing gas from alternative suppliers in the manner suggested by GSC and IPAA. Any pipeline terminating interim transportation that does not accept an Order No. 436 certificate or continue section 311 transportation [28] would be re-

[28] Of course, if the pipeline does accept an Order No. 436 certificate or continues section 311 transportation, transportation would be available to its customers under Order No. 436 on a long-term basis after interim transportation ends.

quired under Order No. 451 to transport gas released under the good faith negotiation rule to its customers or interconnecting pipelines. This requirement would apply to all released gas regardless of whether the release occurred before or after the interim transportation ceased. In addition, the firm sales customers of such a pipeline would be entitled to a right of first refusal as to all released gas not already sold to a third party. With all interim transportation authority scheduled to end upon the processing of certain Order No. 436 filings, it is likely that a substantial portion of the gas ultimately released under the good faith negotiation rule will not be released until after the termination of interim transportation and would thus remain available for the firm sales customers' right of first refusal. This is particulary true in light of the fact that pipelines have no control over the timing of good faith negotiation. Initiation of good faith negotiation is in the sole discretion of the producer. It appears that many producers are delaying initiation of good faith negotiation while they seek voluntary negotiation or for other reasons. Finally, the Commission observes that although pipelines may terminate interim transportation, the Commission has stated that such termination must not be unduly discriminatory.[29]

10. In Order No. 451-A, the Commission held that a non-Order No. 436 pipeline's election to bid less than the highest price permitted under its contract necessarily includes an agreement to waive any full requirements or sole supplier clause which would prevent a firm sales customer from exercising its right of first refusal.[30] Otherwise, the right of first refusal granted such customers would be a nullity. GSC contends that the Commission should extend this waiver requirement to Order No. 436 pipelines. It observes that, in refusing to extend the right of first refusal to the customers of an Order No. 436

[29] *Columbia Gas Transmission Corp.*, 33 FERC ¶ 61,158 (1985).

[30] 51 FR at 46811.

pipeline, the Commission stated that such customers have no need of the right of first refusal, since they can purchase any gas, whether or not previously sold to the pipeline or released under the good faith negotiation rule, and obtain transportation from the Order No. 436 pipeline. However, GSC states that a full requirements clause may bind customers of Order No. 436 pipelines to purchase from the Order No. 436 pipeline, particularly where the pipeline is only performing interim transportation and is thus not subject to the contract demand reduction and conversion rights of § 284.10. GSC states that the Commission has not yet clarified this issue. Accordingly, GSC contends that a requirement that an Order No. 436 pipeline potentially losing gas under the good faith negotiation rule waive any full requirements clause is necessary to ensure that its customers may purchase gas from alternative suppliers.

The Commission will not extend the waiver requirement to Order No. 436 pipelines. Where a pipeline has accepted an Order No. 436 blanket certificate or commences or continues a section 311 transaction after expiration of its interim transportation authorization and is therefore subject to the contract-demand reduction and conversion requirements of § 284.10, it must agree to modify any existing contract terms, such as a full requirements clause, which would prevent the customer's exercise of these options.[31] In such circumstances, therefore, a customer currently subject to a full requirements clause could nevertheless, through the exercise of its contract demand reduction and conversion rights, purchase gas from alternative suppliers and obtain transportation of that gas by the pipeline.[32]

[31] *See* Order No. 436, *FERC Statutes and Regulations, Regulations Preambles 1982-1985* ¶ 30,665, at 31,530, and *Northwest Central Pipeline Co.*, 38 FERC ¶ 61,170, at 61,542-543 (1987).

[32] Of course, since the customer would no longer be a full requirements customer, it might no longer be entitled to purchase gas from the pipeline at the full requirements rate.

Customers of Order No. 436 pipelines performing only interim transportation under section 311 would, it is true, have no contract demand reduction and conversion rights under § 284.10 and thus would be unable to purchase from another supplier unless the pipeline voluntarily agreed to modification of the full requirements clause. However, this situation will be only temporary. Interim transportation is scheduled to cease upon the processing of certain Order No. 436 filings. When that happens, pipelines bust either (1) continue Order No. 436 transportation under a blanket certificate or section 311 which would require them to offer their customers the contract-demand reduction and conversion option in § 284.10 or (2) stop all Order No. 436 transportation, which would require them to waive any full requirements clauses preventing any firm sales customer from exercising the Order No. 451 right of first refusal. In either case, the customers could purchase gas from alternative suppliers. They could also obtain transportation, either under the Order No. 436 non-discriminatory access provisions or under the Order No. 451 transportation obligation. As discussed in the preceding section, the Commission expects that a substantial portion of the gas ultimately released under the good faith negotiation rule will not be released until after interim section 311 transportation ceases and will thus remain available for the Order No. 451 right of first refusal at that time. Accordingly, the Commission believes that the full requirements customers of pipelines currently performing interim section 311 transportation will have ample opportunity to purchase gas from alternative suppliers. Therefore, there is no need to further complicate the rule by requiring pipelines performing interim transportation to waive full requirements clauses.

11. IPAA states that some Order No. 436 pipelines might not provide transportation for amounts of gas below a particular minimum. A package of gas released under the good faith negotiation rule for which transportation is desired might be less than the applicable minimum. In such instances IPAA suggests that the Order No. 451 transportation provisions should apply even though the pipeline is an Order No. 436 pipeline. The Commission refuses to adopt this suggestion. Minimum volume conditions violate the non-discriminatory access provisions of Order No. 436 unless they can be justified as reasonable operating conditions.[33] In *Texas Eastern Transmission Corp.*, the Commission eliminated a minimum volume condition from Texas Eastern's Order No. 436 settlement on the ground that it was not necessary for operational reasons such as ensuring that the quantities of gas to be transported would be large enough to be metered.[34] Where an Order No. 436 pipeline's minimum volume condition is valid as a reasonable operating condition, that condition would likely also be a valid condition to any transportation under Order No. 451, since transportation under that order is also subject to reasonable operating conditions. *See* 18 CFR 284.225(f). Accordingly, if transportation pursuant to Order No. 436 is unavailable because of a minimum volume condition, transportation under Order No. 451 would also be unavailable. Therefore, no purpose would be served by applying the Order No. 451 transportation provisions to Order No. 436 pipelines in the situation described by IPAA.

12. Section 270.226(a) defines upstream pipelines for purposes of the upstream transportation authorization as interstate pipelines "authorized under a certificate of public convenience and necessity" to transport the gas, before its release, between the wellhead and the releasing pipeline. IPAA states that the requirement that the prior transportation have been pursuant to a certificate of public convenience and necessity appears to exclude from

[33] Order No. 436, *FERC Statutes and Regulations, Regulations Preambles 1982-1985* ¶ 30,665, at 31,495.

[34] 37 FERC ¶ 61,260, at 61,680 (1985).

the upstream transportation authorization interstate pipelines previously performing transportation other than under a section 7(c) certificate. An example would be grandfathered section 311 transportation under § 284.105. IPAA requests that the Commission expand the upstream transportation authorization to cover such pipelines. In Order No. 451-A, the Commission stated that the upstream transportation authorization was intended to "serve the twin public interest goals of protecting existing firm customers *and* continuing the flow of gas to the market." [35] Continued upstream transportation by interstate pipelines serves these goals regardless of the authority under which it was previously performed. Accordingly, the Commission is amending § 270.226(a) to remove the requirement that the prior transportation have been pursuant to a certificate of public convenience and necessity.

13. Williams Natural Gas Co. (formerly Northwest Central Pipeline Corporation) has requested that the Commission stay Order Nos. 451 and 451-A pending judicial review. Williams asserts that the final rule adopted in those orders is illegal and will cause Williams irreparable harm. Thirteen producers have submitted a joint answer to Williams' request, opposing it.

The Commission rejected similar stay requests in Order No. 451-A, holding pursuant to the standard set forth in the Administrative Procedure Act, 5 U.S.C. 705 (1982), that justice did not require a stay.[36] For essentially the same reasons, the Commission rejects Williams' stay request. The Commission answered all arguments concerning the illegality of Order No. 451, including those now made by Williams, in detail in Order No. 451-A. Furthermore, Williams's contention that Order Nos. 451 and 451-A will cause it irreparable harm is

[35] 51 FR at 46809 (emphasis in original).

[36] 51 FR at 46817.

speculative and unsubstantiated. There is no certainty that all, or even many, producers who sell gas to Williams will initiate good faith negotiation. Even if all do, Williams could, as stated in Order No. 451-A, offset over two-thirds of any old gas price increase to an estimated market price of $1.80/MMBtu by reducing its new gas WACOG to $1.68/MMBtu, its current all-gas WACOG. Furthermore, the Commission considers it unlikely old gas suppliers could sustain price increases in excess of Williams' $1.68/MMBtu old gas WACOG.[37] In any event, even if Williams does suffer economic damages, such damages are insufficient to constitute "irreparable harm." *See, e.g.*, *Wisconsin Gas Co. v. FERC*, 758 F.2d 669, 674 (D.C. Cir. 1985), citing *Virginia Petroleum Jobbers Association*, 259 F.2d 921, 925 (D.C. Cir. 1958). If the courts modify Order No. 451 on review, monetary adjustments may be made to make the parties whole. Finally, the long-term public interest benefits to consumers and the industry as a whole of the greater degree of market-responsiveness in the gas markets resulting from the rule outweigh any initial detriment to those few entities that benefited from a distorted market.

IV. Effective Date and Paperwork Reduction Act Statement

The amendments to the Commission's regulations adopted in this order on rehearing shall become effective upon issuance of this order except that §§ 284.225(f)(4) and (g) and 284.226(d), involving reporting requirements, shall not become effective until July 9, 1987. In addition, the amendments to 18 C.F.R. 270.201 shall not

[37] Williams' allegations of harm as a result of *Martin's* reversal of Order No. 46 are irrelevant to a consideration of whether Order Nos. 451 and 451-A should be stayed. Any harm, as alleged by Williams, of increased gas sales prices that may result from *Martin* would occur regardless of whether Order Nos. 451 and 451-A were stayed.

apply to negotiations under the good faith negotiation rule comenced by a nomination request under § 270.201 (b)(1) made by the first seller before the issuance of this order.

The Administrative Procedure Act generally requires that a substantive rule be published "not less than 30 days before its effective date." 5 U.S.C. 553(d). However, there are exceptions to the advance notice requirement where a substantive rule "relieves a restriction" or where the Commission otherwise finds good cause to make the rule effective less than 30 days after publication. 5 U.S.C. 553(d)(1) and (3). There is good cause to make the amendments adopted here effective immediately. While the preamble to Order No. 451-A suggested that purchasers could renegotiate in step 2 all gas in multi-vintage contracts as those contracts existed on July 18, 1986, regardless of subsequent assignments, the regulations adopted in that order only permitted purchasers to renegotiate gas currently owned by the assignor or assignee initiating good faith negotiation. *See* the discussion at page 11. Therefore, making the amendments concerning asignments effective immediately is necessary to prevent producers from circumventing the purchaser's step 2 rights through assignments after the issuance of this order. The amendments concerning assignment also relieve a restriction on the ability of purchasers, once good faith negotiation has been initiated, to obtain renegotiation of all gas in multi-vintage contracts as of the issuance of this order regardless of subsequent assignments. The amendment concerning the upstream transportation authorization relieves a restriction on the ability of non-Order No. 436 interstate pipelines to continue upstream transportation of gas released under the good faith negotiation rule regardless of the Commission authority under which the prior transportation was performed, and the amendment concerning transportation by intrastate pipelines relieves a restriction on the ability of intrastate pipelines not desiring to become open access pipelines to transport released gas.

The information collection provisions in this rule are being submitted to the Office of Management and Budget (OMB) for its aproval under the Paperwork Reduction Act [38] and OMB's implementing regulations.[39] Interested persons can obtain information on these information collection provisions by contacting the Federal Energy Regulatory Commission, 825 North Capitol Street, NE., Washington, D.C. 20426 (Attention: Ellen Brown (202) 357-8272). Comments on the information collection provisions can be sent to the Office of Information and Regulatory Affairs of OMB, New Executive Office Building, Washington, D.C. 20503 (Attention: Desk Officer of the Federal Energy Regulatory Commission).

List of Subjects

18 CFR Part 270

Natural gas, Price controls, Reporting and recordkeeping requirements.

18 CFR Part 284

Continental shelf, Natural gas, Reporting and recordkeeping and requirements.

In consideration of the foregoing, the Commission is amending Parts 270 and 284, Title 18, Code of Federal Regulations as set forth below.

By the Commission.

Kenneth F. Plumb.

Secretary.

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[38] 44 U.S.C. 3501-3520 (1982).

[39] 5 CFR 1320 (1986).

Nos. 89-1452 and 89-1453

In the Supreme Court of the United States

OCTOBER TERM, 1990

MOBIL OIL EXPLORATION & PRODUCING SOUTHEAST, INC., ET AL., PETITIONERS

v.

UNITED DISTRIBUTION COMPANIES, ET AL.

FEDERAL ENERGY REGULATORY COMMISSION, PETITIONER

v.

UNITED DISTRIBUTION COMPANIES, ET AL.

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION

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QUESTIONS PRESENTED

1. Whether the Federal Energy Regulatory Commission lawfully exercised its authority to raise the price ceiling for "old" natural gas in conformity with the requirement in Sections 104(b)(2) and 106(c) of the Natural Gas Policy Act of 1978, 15 U.S.C. 3314(b)(2) and 3316(c), that the "higher" price be "just and reasonable within the meaning of the Natural Gas Act."

2. Whether Section 7(b) of the Natural Gas Act, 15 U.S.C. 717f(b), permits the Commission to prescribe in advance and on a generic basis the conditions under which the abandonment of services will be authorized, rather than requiring case-by-case adjudication.

3. Whether the court of appeals erred in holding that the Commission could not adopt the orders at issue here (which increase the price ceiling for old gas but establish a good faith negotiation procedure to protect pipeline-purchasers against automatic imposition of the increase) unless it first solved the problems created by "take-or-pay" clauses in certain pipelines' natural gas contracts, even though the Commission has addressed the "take-or-pay" problem in separate administrative proceedings.

PARTIES TO THE PROCEEDING

The parties to the proceeding in No. 89-1452 are listed in the appendix to the petition in that case at 76a-82a. The petitioner in No. 89-1453 is the Federal Energy Regulatory Commission. The respondents in that case are listed in the appendix to the petition at 83a-86a.

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In the Supreme Court of the United States

OCTOBER TERM, 1990

No. 89-1452

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BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-60a)[1] is reported at 885 F.2d 209. The orders of the Federal Energy Regulatory Commission (J.A. 5-205 (Order No. 451), 206-435 (Order No. 451-A), and 437-467 (Order No. 451-B)) are reported at 51 Fed. Reg. 22,168; 51 Fed. Reg. 46,762; and 52 Fed. Reg. 21,669, respectively.

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[1] "Pet. App." refers to the appendix to the petition for a writ of certiorari in No. 89-1453.

JURISDICTION

The judgment of the court of appeals was entered on September 15, 1989, and petitions for rehearing were denied on December 15, 1989. Pet. App. 61a-62a. The petitions for a writ of certiorari were filed on March 15, 1990, and were granted on June 4, 1990. The jurisdiction of this Court rests upon 28 U.S.C. 1254(1).

STATUTORY AND REGULATORY PROVISIONS INVOLVED

Sections 4(a), 5(a) and 7(b) of the Natural Gas Act of 1938, 15 U.S.C. 717c(a), 717d(a) and 717f(b); Sections 104 and 106 of the Natural Gas Policy Act of 1978, 15 U.S.C. 3314 and 3316; and 18 C.F.R. 157.301, 270.201, 271.402 and 271.602 (the regulations affected by the Orders of the Federal Energy Regulatory Commission) are reproduced in relevant part in an appendix to this brief. App., *infra*, 1a-18a.

STATEMENT

This case involves the validity of Order No. 451 of the Federal Energy Regulatory Commission, which was issued in 1986 to address the serious dislocations in the natural gas market that resulted from the outdated pricing structure for "old" gas (gas that was already in production on the date of enactment of the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. 3301 *et seq.*). Prior to Order No. 451, old gas was divided into a number of categories ("vintages"), for which the price ceiling varied according to such factors as the year production commenced, the size of the producer, whether the gas was sold under a renewal contract, and the region in which the gas was produced. Order No. 451 collapsed those diverse vintages into a single category subject to a single price ceiling. The Commission based its modification of the old gas pricing structure on Sections 104(b)(2) and 106(c) of the NGPA, which permit the Commission, "by rule or order," to raise the ceiling price for "any" old gas to a "higher" price, as long as it is "just and reasonable within the meaning of the Natural

Gas Act." 15 U.S.C. 3314(b)(2), 3316(c). A divided court of appeals in this case held that Order No. 451 was beyond the Commission's authority under the NGPA, even though the court did not disturb the Commission's judgment that the single price ceiling for old gas was "just and reasonable" within the meaning of the Natural Gas Act.

A. Historical Background: The Course of Wellhead Price Regulation

1. Prior to enactment of the Natural Gas Policy Act of 1978, the sale and transportation of natural gas in interstate commerce were regulated by the Commission (and its predecessor, the Federal Power Commission) exclusively under the Natural Gas Act of 1938. Section 4(a) of the NGA imposes on the Commission an obligation to ensure that all rates and charges requested by a regulated natural gas company in connection with the transportation or sale of natural gas within the Commission's jurisdiction are "just and reasonable." 15 U.S.C. 717c(a). Section 5(a) of the NGA similarly provides that when the Commission determines that any "rate, charge, or classification" observed by a natural gas company in connection with the transportation or sale of gas (or any "rule, regulation, practice, or contract" affecting such rate, charge, or classification) is "unjust" or "unreasonable," the Commission "shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order." 15 U.S.C. 717d(a).

As this Court explained in *Public Serv. Comm'n* v. *Mid-Louisiana Gas Co.*, 463 U.S. 319, 327-331 (1983), the Commission, with the approval of the courts, has followed a number of different approaches over the years in giving content to the broad "just and reasonable" standard under the NGA. Initially, when the Commission confined its rate regulation to interstate pipelines, it proceeded on a company-by-company basis, studying the historical costs incurred by each pipeline company in ac-

quiring natural gas for, and transporting gas to, its customers. The Court sustained that approach in *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591 (1944), explaining that Sections 4 and 5 of the NGA do not bind the Commission "to the use of any single formula or combination of formulae in determining rates," and that "[u]nder the statutory standard of 'just and reasonable,' it is the result reached not the method employed which is controlling." 320 U.S. at 602. The Court thus dispelled the notion, emanating from *Smyth* v. *Ames*, 169 U.S. 466 (1898), that the only constitutionally permissible rate structure is one based on the *current* fair value of the utility's assets. See *Duquesne Light Co.* v. *Barasch*, 109 S. Ct. 609, 616-620 (1989).

2. The Commission began to depart from its company-by-company, historical-cost approach after *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672 (1954), which held that the NGA requires the Commission to regulate not only the downstream rates charged by interstate pipelines, but also the upstream sales rates charged at the wellhead by thousands of independent gas producers. In response to *Phillips*, and presented with an overwhelming number of producer rate cases to process, the Commission turned to an "area rate" approach for independent producers, while retaining the individualized "cost-of-service" method of regulation for interstate pipelines.

The area rate approach, as first articulated in 1960 in the Commission's *Statement of General Policy*, No. 61-1, 24 F.P.C. 818, provided for the establishment of a single rate schedule for all gas produced in a given region, based on the region's average production costs, investment, and rates of return. Each area rate schedule contained two separate price ceilings: a lower ceiling for gas prices established in "old" contracts and a higher ceiling for gas prices established in "new" contracts. *Id.* at 819. The Commission rested its two-tiered "vintage pricing" system on the premise that although higher ceiling prices for new gas would encourage additional gas production, "price could not serve as an incentive" for the production of old gas and "any price above average historical costs, plus an appropriate return, would merely confer windfalls." *Permian Basin Area Rate Cases*, 390 U.S. 747, 797 (1968). However, the Commission anticipated that "these differences in price levels will be reduced and eventually eliminated as subsequent experience brings about revisions in the prices in the various areas." 24 F.P.C. at 819.

In *Permian Basin*, the Court sustained the Commission's two-tiered area rate approach. 390 U.S. at 795-799. It held that the courts are without authority to set aside any rate selected by the Commission that is within a "zone of reasonableness," *id.* at 767, and that within this zone, the Commission may "employ price functionally in order to achieve relevant regulatory purposes" and "may, in particular, take fully into account the probable consequences of a given price level for future programs of exploration and production." *Id.* at 797. Accord *Mobil Oil Corp.* v. *FPC*, 417 U.S. 283, 320 (1974).

3. By the time of the rapid rise in natural gas prices during the early 1970s, it had become clear that the two-tiered area rate approach, based on average historical costs, "was not working" and "had led to serious production shortages." *Mid-Louisiana Gas*, 463 U.S. at 330. In response, the Commission shifted to a regime of uniform "national rates" for most gas drilled after December 31, 1972. In Order No. 699 (*National Rates for Natural Gas*, 51 F.P.C. 2212 (1974)), the Commission established a national rate ceiling for gas drilled during the two-year period beginning January 1, 1973, and announced its intention to establish separate price ceilings for gas drilled during each succeeding two-year period. Soon thereafter, in a further refinement of its national rate policy, the Commission "shift[ed] from a pure historical-cost-based to an incentive-price-based approach" and "temporarily abandon[ed] the practice of vintaging." *Mid-Louisiana Gas*, 463 U.S. at 330 (citing *National Rates for Natural Gas*, 52 F.P.C. 1604, 1615-1618, 1636 (1974) (Order No. 699-H)). Specifically, in Order No. 699-H, the Commission: (1) prescribed a national rate designed to "encourag[e] increased future drilling efforts and the

discovery of incremental gas supplies to avert ever deepening natural gas shortages," 52 F.P.C. at 1615, and (2) announced that the Commission would not prescribe different rates for succeeding biennial vintages (as it had recently stated in Order No. 699), but would instead establish a *single* maximum rate for *all* post-1972 gas and periodically revise that single rate. *Id.* at 1636-1638. The Fifth Circuit sustained this shift, noting that the vintage rate structures had been "experimental" from the outset. *Shell Oil Co.* v. *FPC*, 520 F.2d 1061, 1073-1074, 1077-1078 (1975), cert. denied, 426 U.S. 941 (1976); see also *Shell Oil Co.* v. *FPC*, 491 F.2d 82, 87-89 (1974).[2]

The Commission's non-vintage pricing regime for post-1972 gas proved to be short-lived. In Order No. 770 (*National Rates for Natural Gas*, 56 F.P.C. 509 (1976)), the Commission established a new (and substantially higher) national rate ceiling for gas first sold in the 1975-1976 biennium, but it allowed only a smaller increase in the ceiling prescribed by Order Nos. 699 and 699-H for 1973-1974 biennium gas. This reinstitution of vintage pricing for post-1972 gas was sustained by the D.C. Circuit in *American Public Gas Ass'n* v. *FPC*, 567 F.2d 1016 (1977), cert. denied, 435 U.S. 907 (1978), which, like the Fifth Circuit in *Shell Oil*, stressed the

[2] The Commission authorized "small producers" (those selling less than 10 billion cubic feet of gas per year) to sell gas at market-based prices, even if they were above otherwise applicable area or national rates. *Exemption of Small Producers from Regulation*, Order No. 428, 45 F.P.C. 454 (1971). In this manner, the Commission proposed to remove all direct regulation of small producer rates and instead subject those rates only to "indirect regulation"—*i.e.*, to Commission review of the purchased-gas costs of the pipelines and large producers that purchased from small producers. In *FPC* v. *Texaco, Inc.*, 417 U.S. 380 (1974), the Court held that the NGA permits the Commission to undertake such "indirect regulation" and to take market prices into consideration (albeit not to the exclusion of all other factors) when setting producer rates. *Id.* at 387-391, 397-399. However, the Court remanded the case to the Commission because it had failed to articulate a sufficient basis for its order. *Id.* at 395-397.

experimental nature of the Commission's treatment of vintaging. 567 F.2d at 1033-1034. The D.C. Circuit also sustained the Commission's decision in Order No. 770 to increase the price ceiling for gas covered by renewal contracts, finding it appropriate to place a portion of the burden of developing new sources of supply on the consumers whose access to this cheaper gas was "largely an historical accident." *Id.* at 1058.

At about the same time, the Commission consolidated a number of the pre-1973 rates for each separate producing area into a single nationwide category comprised of gas flowing prior to January 1, 1973. Order No. 749 (*National Rates for Natural Gas*, 54 F.P.C. 3090 (1975)). The Fifth Circuit sustained the considerably higher price ceiling that resulted for the oldest of this pre-1973 gas, finding it to be justified by administrative convenience and the need to factor in an allowance for the "replacement cost" of exploring for and developing new sources of supply. *Tenneco Oil Co.* v. *FERC*, 571 F.2d 834, 841-842, cert. denied, 439 U.S. 801 (1978).

Despite this consolidation of the pre-1973 area rates, the Commission's regulations in effect in the mid-1970s continued to provide for a number of separate "vintage" categories of gas, each subject to its own price ceiling. The broadest categories were pre-1973 ("flowing") gas, 1973-1974 biennium gas, and post-1974 gas.[3] But there were three additional categories of pre-1973 gas as well, covering three of the producer areas (Permian Basin, Rocky Mountain, and Appalachian Basin) for which price ceilings higher than the new national ceiling had already been established in separate proceedings. See *Tenneco Oil Co.*, 571 F.2d at 837. The Commission also had created a separate category for gas covered by renewal contracts, discussed above. And to complicate

[3] On March 1, 1977, the Commission initiated proceedings to establish yet another price ceiling for gas from wells commenced on or after January 1, 1977. *Order Instituting National Rate Proceeding*, 57 F.P.C. 1238. However, the Commission took no action on this biennial update after the NGPA bills were introduced in Congress.

matters still further, each of the foregoing categories (except post-1974 gas) was subdivided into two subcategories, one for large producers and one for small producers. As of December 1978, the price ceilings for these 15 categories and subcategories ranged from a high of $1.630 per million BTU's (for all post-1974 gas) to a low of $0.332 per million BTU's (for large-producer pre-1973 gas). See 18 C.F.R. 271.101 (Table II), at 367 (1990).

This, then, was the collection of price ceilings in effect when Congress enacted the Natural Gas Policy Act of 1978.

B. The Pricing Scheme Enacted In The NGPA

The national rate approach, coupled with the Commission's supervision of the complex set of vintage price ceilings, proved inadequate to solve the problems besetting the production and distribution of natural gas. The rate structure caused ceiling prices for interstate gas sales to fall considerably below prices the same gas could command in the intrastate market, which was not federally regulated. The resulting price dichotomy soon resulted in severe gas shortages in the interstate market. Congress responded to this situation by enacting the Natural Gas Policy Act. See *Transcontinental Gas Pipe Line Corp.* v. *State Oil & Gas Bd.*, 474 U.S. 409, 420-421 (1986) (*Transco*); *Mid-Louisiana Gas*, 463 U.S. at 330-331.

The NGPA instituted a "national market price regulatory scheme," covering intrastate as well as interstate sales, the purpose of which is "to assure adequate supplies of natural gas at fair prices." *Transco*, 474 U.S. at 421. The price ceilings established by the NGPA depended primarily upon the date the gas was first produced and the relative difficulty of producing it. Thus, the NGPA established higher ceiling prices for new or hard-to-produce gas and, at the same time, prescribed a scheme of phased deregulation for most such gas. §§ 102, 103, 105, 107, and 108 (15 U.S.C. 3312, 3313, 3315, 3317, 3318). Under that scheme, "the price ceilings for certain 'high-cost' gas were eliminated in 1979, for certain 'old' intrastate gas and 'new' gas in 1985, and for certain other 'new' gas in 1987." *FERC* v. *Martin Exploration Management Co.*, 486 U.S. 204, 207 (1988); see § 121, 15 U.S.C. 3331.

The NGPA adopted a different approach for "old" gas and for certain types of interstate gas subject to "rollover contracts." [4] Sections 104 and 106, 15 U.S.C. 3314 and 3316, furnished initial NGPA price ceilings for this gas by carrying forward the ceilings that previously had been prescribed by the Commission under the NGA, but mandated that those ceilings be automatically adjusted by a monthly inflation factor. 15 U.S.C. 3314(b)(1), 3316(a). The effect was to carry forward (albeit adjusted for inflation) the same 15 vintage price ceilings that happened to be in effect for old gas when the NGPA was enacted. Congress also recognized, however, that the price ceiling for old gas "may be too *low* and authorize[d] the Commission to raise it whenever traditional NGA principles would dictate a higher price." *Mid-Louisiana Gas*, 463 U.S. at 333 (citing NGPA Sections 104 and 106). Specifically, Sections 104(b)(2) and 106(c) both authorize the Commission, "by rule or order," to prescribe a "higher" ceiling price for old gas, "if such price is * * * just and reasonable within the meaning of the Natural Gas Act." 15 U.S.C. 3314(b)(2), 3316(c).

The Court described the overall thrust of this comprehensive new regulatory scheme in *Mid-Louisiana*, 463 U.S. at 333:

> In each category of gas, the statute explicitly establishes an incentive pricing scheme that is wholly divorced from the traditional historical-cost methods applied by the Commission in implementing the NGA. The price is established either in terms of a dollar figure per million Btu's, or in terms of a previously

[4] Section 2(12) of the NGPA defines a "rollover contract" as a contract entered into on or after November 8, 1978, for the first sale of natural gas that was previously subject to a contract that expired at the end of a fixed term specified in the contract itself. 15 U.S.C. 3301(12).

existing price, and is inflated over time according to a statutory formula.

C. Promulgation of Order No. 451

The NGPA went far to remedy the disparity that had developed between the interstate and intrastate natural gas markets under the NGA, and the higher prices permitted by the NGPA led to increased gas production, which alleviated shortages. Nevertheless, as the court below recognized, the "natural gas market became fraught with distortions." Pet. App. 9a. For example, although the greater production fostered by the NGPA, coupled with decreased demand, led to excess supply, prices paid by consumers continued to increase. Furthermore, the lower ceiling prices for old gas that were carried forward for the time being under the NGPA led to inadequate development and premature abandonment of extensive reserves of old gas, even though the marginal cost of producing old gas often was less than the marginal cost of producing other types of gas. The resulting shift to production of new and high-cost gas, rather than development of extensive old gas reserves, produced higher prices for consumers and created incentives to import foreign oil and gas. 51 Fed. Reg. 22,174-22,175 (1986) (J.A. 32-36).

Against this background, the Secretary of Energy, pursuant to Section 403 of the Department of Energy Organization Act, 42 U.S.C. 7173, formally recommended that the Commission issue a notice of proposed rulemaking to revise the pricing system for old gas. 50 Fed. Reg. 48,540 (1985). The Commission initiated those proceedings in November 1985. After reviewing extensive comments filed by all segments of the natural gas industry and after holding a two-day public conference, the Commission issued Order No. 451, at issue here, in June 1986. 51 Fed. Reg. 22,168 (J.A. 5-205). In December 1986, the Commission issued Order No. 451-A, which reaffirmed the basic approach of Order No. 451, while modifying certain of its details. 51 Fed. Reg. 46,762 (J.A. 206-436).

1. Based on the voluminous record of the rulemaking proceedings, the Commission concluded that the maximum lawful prices for old gas should be raised, because the vintage prices "fail[ed] to assign a reasonable share of the replacement cost or marginal cost of new supplies to purchasers of old gas." 51 Fed. Reg. at 22,170 (J.A. 15). The Commission made several critical findings on this point. First, it agreed with the Secretary of Energy and other commenters that valuable supplies of inexpensive old gas that remained subject to the price ceilings carried forward under Sections 104(b)(1) and 106(a) of the NGPA were being inadequately developed or prematurely abandoned. In the Commission's judgment, an increase in old gas prices would encourage recovery of an additional 11 trillion cubic feet of natural gas that otherwise would be permanently lost. 51 Fed. Reg. at 22,170, 22,172, 22,180, 46,774-46,779 (J.A. 15, 24, 54, 259-275). Second, the Commission determined that the various vintage ceilings, as then preserved, kept old gas priced well below the competitive market price for wellhead sales of higher-priced new gas, thereby creating an artificial and unfair competitive advantage for those pipelines that had access to large supplies of old gas and for the regions and customers served by those pipelines. "This means consumers, purely by the accident of vintaging, pay different gas prices for reasons wholly unrelated to the value of the commodity or the cost of replacing it." *Id.* at 22,172, 46,766 (J.A. 25, 227).[8] Third, the Commission found that the low prices for old gas further distorted the market by permitting producers that had a cushion of old gas to "roll in" the prices of new and deregulated gas with artificially low prices for old gas, thereby enabling them to charge a higher price for incremental supplies of new and deregulated gas than pur-

[8] The Commission noted that as a result of differing access to old gas, the average residential price of gas in Maine and Connecticut in 1984 was $9.58 and $8.80 per thousand cubic feet (Mcf), respectively, while in Arkansas and Kansas it was only $4.37 and $4.49 per Mcf. 51 Fed. Reg. at 22,176 (J.A. 39).

chasers otherwise would be willing to pay. *Id.* at 22,172 (J.A. 25); see generally *id.* at 46,765-46,768 (J.A. 223-233).

For the foregoing reasons, the Commission found that the then-existing vintage price structure for old gas was "the major cause of the market distortions identified by the Commission," and it accordingly determined that the price ceilings for old gas were unjust and unreasonable within the meaning of the NGA. 51 Fed. Reg. at 22,182, 46,765-46,766 (J.A. 62, 223-224). The Commission further concluded that "the current problems being experienced in natural gas markets would largely be remedied by collapsing vintages and raising ceiling prices of below-market priced gas." *Id.* at 22,182 (J.A. 63); see also *id.* at 46,766-46,767 (J.A. 224-231). The Commission therefore decided to consolidate the 15 separate vintage categories of old gas into one category and to establish an alternative maximum price that a producer may charge for gas in that category—but only to a willing purchaser. See pages 13-15, *infra*.

Specifically, this single new category was made subject to a price ceiling equal to the highest of the ceilings then in effect for old gas (that having a post-1974 vintage), adjusted monthly for inflation. 51 Fed. Reg. at 22,183-22,185 (J.A. 69-77); see 18 C.F.R. 271.402(c)(3)(iii) and (7), 271.602(a)(3). The Commission explained that the ceiling price for old gas should approximate, as closely as possible, the replacement cost of that gas, in order to assure an adequate long-term supply. Because the Commission and the D.C. Circuit had found the ceiling price for post-1974 gas to be just and reasonable inasmuch as it was based on the then-current costs of finding and producing gas—and because the ceiling price for post-1974 vintage gas had been adjusted for inflation since 1977—the Commission concluded that the ceiling as so adjusted (which stood at $2.57 per million BTUs) approximated replacement cost in 1986 and therefore was "just and reasonable" within the meaning of the NGA. 51 Fed. Reg. at 22,183-22,190, 22,194, 46,768, 46,771-46,774 (J.A. 69-95, 109-112, 233-235, 245-257).

The Commission recognized that this alternative ceiling price exceeded the then-current market price for old gas, but it noted that the ceiling "is no higher than the highest vintage rate Congress itself retained for flowing gas under the NGPA"—*i.e.*, the rate carried forward by Section 104(b)(1) for post-1974 old gas. 51 Fed. Reg. at 22,177 (J.A. 43). Moreover, the Commission projected that in the long term, market forces would result in lower (and more stable) prices overall, as trillions of additional cubic feet of the relatively low-cost old gas increasingly competed with higher-priced categories of gas. 51 Fed. Reg. at 22,190-22,204, 46,779-46,784 (J.A. 95-141, 276-295). The Commission found this projection to be supported by: (1) Congress's judgment when it enacted the NGPA that the wellhead market for natural gas had become competitive, (2) the declining price of gas that had been decontrolled under the NGPA, and (3) the fact that the market price of other gas still subject to regulation under different sections of the NGPA was substantially below the statutorily prescribed ceilings. *Id.* at 22,195-22,198 (J.A. 115-127).

2. The Commission also included in Order No. 451 important protections for pipelines and other purchasers. By virtue of this Court's decision in *United Gas Pipe Line Co.* v. *Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956), a producer could not charge the higher rate permitted by the Commission's new ceiling in Order No. 451 unless its contract with the purchaser permitted the increase. However, the Commission recognized that many existing gas contracts contained indefinite price-escalation clauses, under which the price the purchaser was obligated to pay could rise to the maximum lawful price allowed by the Commission under the NGA and the NGPA. In the Commission's view, producers that were parties to such contracts should not automatically be entitled to receive the new ceiling price, because the ceiling would then become a floor and the natural gas market would be subject to the same sorts of distortions that led to enactment of the NGPA. 51 Fed. Reg. at 22,204 (J.A. 141). Ac-

cordingly, the Commission conditioned a producer's right to collect higher rates under Order No. 451 upon the producer's entering into a voluntary agreement with the existing purchaser to that effect or its invocation of a structured "Good Faith Negotiation" (GFN) procedure prescribed by Order No. 451. See generally *id.* at 22,204-22,209, 46,784-46,802 (J.A. 141-163, 295-367).

The GFN procedure, which is codified at 18 C.F.R. 270.201 (App., *infra*, 7a-16a), consists of several steps. First, a producer may request a purchaser to nominate the price at which it would be willing to continue to purchase old gas under one or more contracts between the parties. 18 C.F.R. 270.201(b)(1). However, such a request is deemed to constitute an offer by the producer to release the purchaser from its contractual obligation to purchase any gas sold under *any* existing contract between the two parties that includes the sale of old gas (not merely the contract(s) named in the producer's request). 18 C.F.R. 270.201(b)(4). Upon receipt of the producer's request, the purchaser not only may nominate a price at which it would continue to purchase gas under the contract(s) specified by the producer, but also may make a counter-request of the *producer* to nominate a price at which the *producer* would be willing to continue selling any gas (old or new) under any contracts specified by the purchaser that cover at least some old gas. 18 C.F.R. 270.201(b)(2).

If, after the nominations, the producer and the purchaser are unable to agree on a new price for gas covered by an existing contract, the producer must continue sales to the purchaser at the same price, although it may abandon its contract service obligations to that purchaser if (1) it has executed a contract with another willing purchaser for the released gas, and (2) it furnishes at least 30 days' notice to the former pipeline-purchaser. See 18 C.F.R. 157.301, 270.201(c)(1) and (e)(4). But the purchaser has an important reciprocal right: if the producer does not agree to the price the purchaser nominates, the purchaser may terminate its purchase obligations under any of the contracts named in its counter-request. 18

C.F.R. 270.201(c)(2) and (f)(3). The GFN procedure thus serves as an inducement for both parties either to reach agreement on a new sales price or to release the gas for sale to others at market rates.

3. Finally, the Commission rejected suggestions by some commenters that it should use the Order No. 451 rulemaking as the vehicle for a comprehensive resolution of various issues raised by so-called "take-or-pay" clauses in natural gas contracts,[6] or should refrain from adopting Order No. 451 until the take-or-pay issue was finally resolved. The Commission reasoned that the effect of Order No. 451 would be to lower the overall market price of all gas, which would mitigate the pipelines' take-or-pay exposure. In addition, the Commission pointed out that it was addressing the take-or-pay issue in separate proceedings on Order No. 436,[7] which had already induced substantial settlements of pipelines' take-or-pay liabilities to producers, and that the GFN process, if invoked by a producer as a precondition to collecting higher rates for old gas, would have the salutary effect of encouraging renegotiation of many contracts to eliminate or modify the take-or-pay clauses. 51 Fed. Reg. at 22,174-22,175, 22,183, 22,196-22,197, 46,783-46,784 (J.A. 33-36, 66-69, 120-124, 292-295). Indeed, the Commission pointed out that the GFN procedure, permitting a purchaser to nominate a price it is willing to pay for all gas (old and new) under existing contracts and to terminate its contract obligation if the producer does not agree to that price,

[6] Such a clause requires a pipeline to take a specified volume of gas from a producer or, if it is unable to do so, to pay for the specified volume. See *Transco*, 474 U.S. at 412.

[7] Order No. 436, *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, 1982-1985 FERC Stats. & Regs. [Regs. Preambles] (CCH) ¶ 30,665 (1985), aff'd in part and remanded in part *sub nom. Associated Gas Distributors* v. *FERC*, 824 F.2d 981 (D.C. Cir. 1987), cert. denied, 485 U.S. 1006 (1988). The background of the take-or-pay problem and the Commission's subsequent measures to address it are explained in greater detail in our petition for a writ of certiorari (at 4-13) in *FERC* v. *Associated Gas Distributors*, petition for cert. pending, No. 89-2016 (filed June 22, 1990).

"provides the purchaser with a powerful additional bargaining card to negotiate a lower price for new gas in multi-vintage contracts." *Id.* at 22,197 (J.A. 122).

D. The Decision of the Court of Appeals

Numerous producers and purchasers of natural gas thereafter sought judicial review of Order No. 451 (as modified on rehearing by Order No. 451-A). With one exception, none of the respondents sought a stay of the final Order pending review, and the court of appeals denied the application by the one respondent (Williams Natural Gas) that did seek a stay. As a result, the new pricing system and Good Faith Negotiation procedure established by Order No. 451 were permitted to go into effect, and they have resulted in the renegotiation of numerous producer-pipeline contracts since that time. See 89-1452 Pet. 3, 13, 17-18, 26-27; 89-1453 Pet. 16, 26.

1. On September 15, 1989, a divided panel of the court of appeals held Order No. 451 invalid and vacated the Order in its entirety. Pet. App. 1a-60a. The court expressly did not suggest that the Commission was "misguided" in its conclusion that the disorder in the natural gas market had resulted, at least in part, from the vintage pricing structure for old gas. *Id.* at 20a. Nor did it overturn the Commission's finding that the higher ceiling price for old gas under Order No. 451 is "just and reasonable" within the meaning of the NGA. The court nevertheless held that the uniform ceiling price for all old gas under Order No. 451 is wholly beyond the Commission's statutory authority to prescribe. Pet. App. 16a-23a. The court dismissed the Commission's reliance on the express authorization in Sections 104(b)(2) and 106(c) to impose "higher" rates for old gas, as long as they are "just and reasonable," as a "somewhat ingenious application of the plain meaning rule of statutory construction." Pet. App. 21a. It instead believed that Sections 104(b)(2) and 106(c) should be read to confer only "limited authority" on the Commission, and would be "more appropriately interpreted as special relief measures to be utilized in the event that existing con-

gressional ceiling prices become confiscatory." Pet. App. 22a-23a & n.24.

The court did not point to any statutory language that confines the Commission's authority under Sections 104(b)(2) and 106(c) in this manner. Rather, in rejecting the Commission's approach, the court relied solely on floor statements by several Members of Congress concerning what the court believed to be the "essence" of the legislative compromise leading to enactment of the NGPA. Pet. App. 17a-20a & n.22. In its view, those floor statements (none of which addressed the Commission's authority under Sections 104(b)(2) and 106(c)) revealed a legislative intent to concentrate the rewards of higher prices solely on the development of new, high-cost gas and to guard against what the court labeled "de facto deregulation" of old gas prices. Pet. App. 17a. This legislative history, the court concluded, did not authorize the Commission to "break[] virgin ground" under the just and reasonable standard by "abrogating the vintage pricing structure" for old gas. *Id.* at 22a-23a & n.24.

The court also invalidated the provisions of Order No. 451 that permit a producer to abandon existing service obligations if it does not reach agreement with its pipeline customer on a new price under the GFN procedure. Pet. App. 24a-28a. The court acknowledged that the D.C. Circuit had found "no procedural objection" under Section 7(b) of the NGA, 15 U.S.C. 717f(b), to the Commission's identification, in an otherwise valid rule, of circumstances "which automatically trigger its approval of abandonment," and that the D.C. Circuit likewise had found it "well-established that the Commission need not hold an evidentiary hearing when no issue of material fact is in dispute." Pet. App. 26a (quoting *Associated Gas Distributors* v. *FERC*, 824 F.2d 981, 1015 n.17 (D.C. Cir. 1987), cert. denied, 485 U.S. 1006 (1988), and *Kansas Power & Light Co.* v. *FERC*, 851 F.2d 1479, 1484 (D.C. Cir. 1988)). The court nonetheless believed that the Commission "ha[d] abdicated its responsibility under Section 7(b) of the NGA" by pro-

viding abandonment authorization on a generic, rather than on a case-specific, basis and by placing undue reliance on the GFN procedure. Pet. App. 28a. Moreover, although the Commission pointed out that under Order No. 451, "prior abandonment approval has, in fact, been granted by the Commission," *id.* at 27a, the court perceived an inconsistency with *United Gas Pipe Line Co.* v. *McCombs*, 442 U.S. 529 (1979), in which this Court reversed an appellate decision that permitted a producer to abandon sales without any prior Commission approval. Pet. App. 27a-28a.

Finally, the court held that the Commission had erred in failing to resolve the problem of high-cost take-or-pay contracts in the context of Order No. 451, even though it recognized that the Commission was addressing the very same problem in separate proceedings. Pet. App. 29a-32a. The court was unpersuaded by the Commission's finding that the GFN procedure would ameliorate the problem in the context of this proceeding. *Id.* at 31a-32a. The court regarded the GFN procedure as too "one-sided" because it is initiated by the producer-seller and because, the court believed, it offers insufficient bargaining power to the pipeline-purchaser. *Ibid.*; see also *id.* at 24a n.26, 28a. The court reached this conclusion even though it elsewhere acknowledged that in the absence of the GFN procedure, a producer would automatically be entitled to receive the higher ceiling price under a price-escalation clause. *Id.* at 29a.[8]

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[8] The majority also struck down the related requirement in Order No. 451 that a pipeline continue to transport old gas that is released from its contract with the producer and sold to another purchaser. Pet. App. 32a-35a; see 18 C.F.R. 270.201(h). As the majority acknowledged (Pet. App. 32a n.34), however, and as respondents concede (Br. in Opp. 12 n.6), the continuing transportation obligation is of little practical significance, because all of the major interstate pipelines have now applied for or accepted "blanket" transportation certificates obligating them to provide transportation service to all shippers on a non-discriminatory basis. 18 C.F.R. 284.8(b), 284.9(b), 284.221-284.226; see S. Rep. No. 38, 101st Cong., 1st Sess. 6 (1989). In these circumstances, no petitioner has sought further review of this transportation issue.

2. Judge Brown dissented. Pet. App. 36a-60a. He believed that the majority had improperly "[f]ail[ed] to accord to the [Commission] the expertise which Congress invests in it," "[o]verlook[ed] specific congressional language giving express legislative authority to raise the price of old gas," and "[s]ubstitute[d] its own judgment for that of the Commission on what Congress has ordained the Commission may do about the grave problems of the natural gas business." *Id.* at 36a-37a (emphasis omitted). In Judge Brown's view, "Congress could not have been more explicit in authorizing the Commission to raise statutory ceiling prices for committed or dedicated gas sales 'if such [higher] price is just and reasonable within the meaning of the [NGA].'" *Id.* at 47a (quoting 15 U.S.C. 3314(b)(2) and 3316(c)). "This means," he continued, "that Congress granted the Commission the express authority to raise the ceiling prices for vintage gas sales," and "[t]he sweeping nature of this legislative grant is reflected by expressly allowing this authority to be exercised 'by rule or order.'" Pet. App. 47a-48a. Judge Brown also was of the view that the price ceiling prescribed by the Commission is "just and reasonable" within the meaning of the NGA, since the record "fully supports" the Commission's judgment that "overall and in the long term prices would be lower than otherwise because of the increased supply of relatively lower-priced old gas into the open market competing with the more expensive, incentive-priced and deregulated gas." *Id.* at 50a.

Judge Brown further concluded that the pre-granted abandonment authorization in Order No. 451 is lawful, Pet. App. 52a-55a, because Section 7(b) of the NGA "does not require that the Commission act on such matters only case-by-case." *Id.* at 53a. Finally, he disagreed with the majority's direction to the Commission "to consider, and once and for all to *solve*, a matter so perplexing and complex as the issue of take-or-pay contracts." *Id.* at 57a. He pointed out that "reform may take one step at a time," *id.* at 59a (quoting *Williamson* v. *Lee Optical of Oklahoma, Inc.*, 348 U.S. 483, 489 (1955)),

and believed that Order No. 451 in any event "provides pipelines with the means to address take-or-pay problems" in negotiations under the GFN procedure. *Ibid.*

3. On January 16, 1990, this Court stayed the mandate of the court of appeals pending the timely filing and disposition of petitions for a writ of certiorari. No. A-503.

INTRODUCTION AND SUMMARY OF ARGUMENT

Order No. 451 is one of several major administrative measures adopted by the Federal Energy Regulatory Commission to address the artificial regional disparities, production disincentives, and other significant distortions that continued to plague natural gas production and distribution in the United States in the mid-1980s. After exhaustive analysis, the Commission concluded that the anachronistic, multi-tiered system of vintage pricing still in effect for "old" gas substantially contributed to these conditions, and it therefore concluded that vintage pricing should be eliminated.

Exercising its express authority under the NGPA to establish a higher ceiling price for old gas as long as it is "just and reasonable" within the meaning of the Natural Gas Act, the Commission collapsed the 15 different vintages of old gas into a single category to be covered by a single price ceiling. The ceiling the Commission chose was the one already in effect for one of the 15 vintages (post-1974 old gas). That ceiling previously had been found by the Commission to be "just and reasonable" for post-1974 gas in Order No. 770 ten years earlier, had been sustained by the D.C. Circuit on judicial review of Order No. 770 in *American Public Gas Ass'n* v. *FPC*, 567 F.2d 1016 (1977), cert. denied, 435 U.S. 907 (1978), and had been carried forward by Congress itself through Section 104(b)(1) of the NGPA. After thoroughly reexamining that rate (as adjusted for inflation in accordance with the NGPA), the Commission once again found it to be "just and reasonable," this time for all categories of old gas.

The Commission also adopted a balanced and carefully structured Good Faith Negotiation procedure that must be invoked by a producer as a condition precedent to demanding rates permitted by the higher price ceiling for old gas. This procedure was designed to assure that the ceiling did not unfairly prejudice pipelines that had agreed to open-ended price-escalation clauses (which otherwise would have permitted producers to collect higher rates on demand) and to afford pipelines significant leverage in resolving their liability under "take-or-pay" contracts with producers.

Order No. 451 has had a significant effect on the natural gas industry since it went into effect more than three years ago. It has led to the successful negotiation or renegotiation of numerous contracts between producers and pipelines, some of which address take-or-pay issues between the parties as well. Moreover, the Commission's projection when it issued Order No. 451 that the overall price of natural gas would decrease has proven to be accurate, as the natural gas market has become increasingly competitive. The court of appeals erred in now setting aside this important effort to reform the pricing structure for old gas.

I. The court of appeals did not disturb the Commission's expert judgment that the system of disparate vintage price ceilings for old gas no longer yielded rates that were "just and reasonable" within the meaning of the Natural Gas Act standard incorporated into the NGPA and that the single new ceiling adopted for old gas in Order No. 451 does, by contrast, satisfy that flexible standard. In any event, the Commission's judgment on these points is sound and exhaustively documented: the new ceiling was designed to bring about lower prices for consumers generally, create incentives to produce an additional 11 trillion cubic feet of old gas, reduce inequities among purchasers that had unequal access to old gas, and remove obstacles in the transition to the fully competitive market Congress envisaged.

Nevertheless, without pointing to any statutory provision that prohibits what the Commission did, the court

of appeals held that the Commission had exceeded its statutory authority for eliminating price vintaging. As a result, the court effectively removed from the Commission's regulatory jurisdiction the price ceilings that the Commission itself had put in place. And in doing so, it accorded a permanent and exalted status to the particular hodge-podge of price ceilings that happened to be in effect for a brief time in the midst of the far different and rapidly changing market and regulatory climate that immediately preceded passage of the NGPA almost 12 years ago. These perverse results cannot be squared with the text of Sections 104(b)(2) and 106(c) of the NGPA, which expressly incorporates the flexible "just and reasonable" standard of the Natural Gas Act, or with the experience under that standard preceding enactment of the NGPA, when the Commission, sustained by the courts, constantly revised the rates for these same categories of gas in response to changing market and other conditions. The court of appeals' holding thus is inconsistent with the Commission's broad mandate under the NGPA "to overse[e] a national market price regulatory scheme." *Transcontinental Gas Pipe Line Corp.* v. *State Oil & Gas Bd.*, 474 U.S. 409, 421 (1986).

II. The court of appeals likewise erred in invalidating the provisions of Order No. 451's Good Faith Negotiation procedure that specify in advance the conditions under which a producer is permitted by the Commission to abandon its contract service obligations to the purchaser. Section 7(b) of the Natural Gas Act provides that "[n]o natural gas company shall abandon * * * any service * * * without the permission and approval of the Commission first had and obtained, after due hearing, and a finding by the Commission * * * that the present or future public convenience or necessity permit such abandonment." Those requirements were satisfied here. The Commission gave its "permission and approval" for the abandonments covered by the Order, based on a finding that the "public convenience or necessity" would be served by releasing the gas to another purchaser when

the GFN procedure fails to result in an agreement between the parties. And because the relevant legislative-type facts supporting Order No. 451, including its abandonment component, were resolved in the rulemaking proceedings, no further hearing is "due" for relitigation of those issues in the context of each individual abandonment.

III. The court of appeals plainly overstepped its role by insisting that the Commission must comprehensively solve the problems created by "take-or-pay" clauses to which the pipelines themselves agreed before the Commission may exercise its express authority under the NGPA to raise the price ceiling for old gas. The court was apparently unaware of the extensive and largely successful undertakings by the Commission to address the take-or-pay problem, which have resulted in the settlement of current or future take-or-pay liabilities of pipelines to producers totalling approximately $44 billion. In any event, established principles of judicial review preclude the court of appeals from reordering the Commission's rulemaking proceedings and priorities.

IV. The soundness of the Commission's judgment in raising the ceiling price of old gas and instituting the related measures in Order No. 451 is confirmed by Congress's enactment of the Natural Gas Wellhead Decontrol Act of 1989, Pub. L. No. 101-60, § 2(b), 103 Stat. 158, which builds upon the Commission's efforts, including Order No. 451, to promote a fully competitive natural gas market.

ARGUMENT

I. THE ALTERNATIVE PRICE CEILING IN ORDER NO. 451 IS FULLY CONSISTENT WITH THE "JUST AND REASONABLE" STANDARD INCORPORATED INTO SECTIONS 104(b)(2) AND 106(c) OF THE NATURAL GAS POLICY ACT OF 1978

In holding that the Commission is without authority to revise the anachronistic system of vintage pricing for old gas, the court below disregarded the plain meaning of the relevant statutory provisions and the settled judicial construction of the "just and reasonable" standard that Congress incorporated into the Natural Gas Policy Act. Rather than seizing upon a few vague statements by individual Members of Congress to fashion an absolute barrier to the Commission's actions that appears nowhere in the Act, the court of appeals should have measured the price features of Order No. 451 against the principles developed under the "just and reasonable" standard that *does* appear in the Act. Under those principles, Order No. 451 is clearly valid.

A. The NGPA Expressly Authorizes The Commission To Adopt A "Higher" Ceiling Price For Old Gas Where, As Here, That Price Is "Just And Reasonable"

The starting point for any analysis of the Commission's statutory responsibilities is, of course, the language of the NGPA itself. "If the statute is clear and unambiguous, 'that is the end of the matter, for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress.'" *Sullivan* v. *Stroop*, 110 S. Ct. 2499, 2502 (1990) (quoting *K Mart Corp.* v. *Cartier, Inc.*, 486 U.S. 281, 291 (1988)). But if the statute is ambiguous, the court must defer to a reasonable administrative interpretation. *Chevron U.S.A. Inc.* v. *NRDC, Inc.*, 467 U.S. 837, 843-844 (1984); see *Pension Benefit Guaranty Corp.* v. *LTV Corp.*, No. 89-390 (June 18, 1990), slip op. 12-17. Even greater deference is required where, as here, Congress has charged an

agency with giving more particularized content to broad statutory standards by issuing rules having legislative effect. *Atkins* v. *Rivera*, 477 U.S. 154, 162 (1986); see also *Sullivan* v. *Zebley*, 110 S. Ct. 885, 890 (1990). And in the special area of ratemaking, "the breadth and complexity of the Commission's responsibilities demand that it be given every reasonable opportunity to formulate methods of regulation appropriate for the solution of intensely practical difficulties." The Commission's orders therefore "may not be overturned if they produce 'no arbitrary result.'" *Permian Basin*, 390 U.S. at 790.

Here, as in the Court's last case arising under the NGPA, "[t]he plain meaning of the statute decides the issue presented." *FERC* v. *Martin Exploration Management Co.*, 486 U.S. 204, 209 (1988). Sections 104 and 106 of the NGPA unambiguously authorize the Commission to increase the ceiling price for old gas and interstate rollover gas "whenever traditional NGA principles would dictate a higher price." *Mid-Louisiana Gas*, 463 U.S. at 333. By contrast, the text of those Sections lends no support whatever to the court of appeals' view that Congress withheld that broad authority from the Commission and instead froze the prior system of vintage pricing. If the court of appeals had any doubt on this score, however, it should have deferred to what is, at the very least, a permissible interpretation of the relevant statutory provisions by the expert agency charged with their administration.

1. Section 104(b)(1)(A)(i) and (ii) of the NGPA provides that the maximum ceiling price for old gas shall be the "just and reasonable rate * * * established by the Commission which was * * * applicable to the first sale of such natural gas on April 20, 1977," adjusted by an inflation factor for each month since April 1977. 15 U.S.C. 3314(b)(1)(A)(i) and (ii); see § 101, 15 U.S.C. 3311.[9] Section 106(a)(1) similarly provides that the ceil-

[9] The NGPA also carries forward any "just and reasonable rate" established by the Commission after April 27, 1977, but before the NGPA's effective date. 15 U.S.C. 3314(b)(1)(B). This provision is of little practical significance.

ing price for gas covered by an interstate rollover contract shall be "the just and reasonable rate, if any, * * * established by the Commission" for the gas on the effective date of the NGPA. 15 U.S.C. 3316(a)(i).[10] By enacting these provisions, Congress carried forward for the time being the ceiling price for each of the various vintages listed in the Commission's regulations at the time the NGPA was enacted.

Congress did not, however, mandate that the ceilings based on those grandfathered rates (as adjusted for inflation) remain permanently fixed. To the contrary, it expressly authorized the Commission to prescribe a different ceiling for old gas, just as it was free to do under the NGA before the NGPA was enacted. Section 104 (b)(2) of the NGPA provides (15 U.S.C. 3314(b)(2)):

> **Ceiling prices may be increased if just and reasonable.** The Commission may, by rule or order, prescribe a maximum lawful ceiling price, applicable to any first sale of any natural gas (or category thereof, as determined by the Commission) otherwise subject to the preceding provisions of this section, if such price is—
>
> (A) higher than the maximum lawful price which would otherwise be applicable under such provisions; and
>
> (B) just and reasonable within the meaning of the Natural Gas Act.

Section 106(c) of the NGPA, 15 U.S.C. 3316(c), which governs interstate rollover contracts, is essentially identical.

The only restrictions on the Commission's authority under Sections 104(b)(2) and 106(c) are: (1) any revised ceiling price prescribed by the Commission must be "higher" than the applicable grandfathered rate (as adjusted for inflation), and (2) the higher rate must be "just and reasonable within the meaning of the Natural

[10] Section 106(a)(2) provides an alternative ceiling of $0.54 per million Btu's if that is higher than the rate previously established by the Commission. 15 U.S.C. 3316(a)(2).

Gas Act." Both of these requirements were satisfied here. First, the single ceiling price adopted by the Commission in Order No. 451 is "higher" than each of the ceilings carried forward by Sections 104(b)(1) and 106(a)—except, of course, for post-1974 old gas, for which the ceiling price remains the same.

Second, the Commission found, after extensive analysis, that the higher ceiling price is "just and reasonable" within the meaning of the Natural Gas Act. See pages 11-13, *supra*. The price ceiling selected by the Commission for all old gas is not an arbitrary number without any relation to costs or prior ratemaking practices. The Commission collapsed all of the pre-NGPA vintages of old gas into a single vintage subject to a single price ceiling that the Commission, employing traditional NGA principles of "just and reasonable" ratemaking, had *already* found to be a "just and reasonable" price, for gas having a post-1974 vintage. That determination, in Order No. 770, was sustained by the D.C. Circuit in *American Public Gas Ass'n* v. *FPC*, *supra*, and was carried forward by Congress itself in Section 104(b)(1) of the NGPA. The Commission rationally determined that this ceiling, as periodically adjusted upward for inflation, did not become any less "just and reasonable" simply because market prices had since dipped below that level, presumably to the benefit of consumers. See *Martin Exploration*, 486 U.S. at 208 ("by 1984 the market price of natural gas had plunged below the regulated price ceilings").[11] And because the rationale for estab-

[11] There is no merit to respondents' contention (Br. in Opp. 21-23) that the Commission engaged in impermissible "*de facto* deregulation" because the ceiling now is above the market price for natural gas. *All* old gas remains subject to a regulated price ceiling, which may later be adjusted if necessary to assure just and reasonable rates. 51 Fed. Reg. at 22,211, 46,764-46,765 (J.A. 170-171, 219-222). That is all the NGA and NGPA require. Indeed, the ceiling price for post-1974 old gas that is carried forward by Section 104(b)(1), which stood at $2.94 as of April 1990 (18 C.F.R. 271.101 (Table II), at 376 (1990)), is above the market price; and the Commission cannot lower that ceiling because Section 104(b)(2)

lishing different ceilings for the other vintages of old gas had long since disappeared, it was not arbitrary for the Commission to conclude that *all* of those other vintages should now be brought under this same price ceiling. That is especially so since the uneven access of different pipelines and consumers to low-cost old gas, which was in many instances an "historical accident," *American Public Gas Ass'n* v. *FPC*, 567 F.2d at 1058, had led to widely divergent prices for consumers and had seriously distorted the increasingly competitive market for natural gas at the wellhead—consequences that the Commission permissibly could determine were neither "just" nor "reasonable."

The Commission also explained that the price ceiling for post-1974 gas that it was extending to all old gas approximated the "replacement cost" of that gas, which, in the current setting, corresponds to a "just and reasonable" price ceiling. Although that ceiling exceeded the then-prevailing market price, the Commission concluded that from a long-term, national perspective, permitting producers to bargain for a price for old gas up to its replacement cost would satisfy the NGPA's overriding objective of assuring an adequate supply of natural gas at fair prices and, in particular, would result in production of an additional 11 trillion cubic feet of old gas. In the Commission's judgment, as more of this relatively

requires that any revised ceiling be "higher." See Pet. App. 23a n.24; see also *Mid-Louisiana Gas*, 463 U.S. at 333. It could not seriously be maintained that post-1974 gas has for this reason become "deregulated." There is no reason for a different conclusion with respect to the other old gas to which the Commission has extended that same ceiling.

The decline in market prices recognized in *Martin Exploration* did, however, restrict the Commission's options once it concluded that the old gas vintage price structure no longer was just and reasonable. The Commission could not have collapsed all of the vintage categories into a single category subject to a ceiling at or below the market price of old gas without lowering the ceilings applicable to the most recent (and highest-priced) vintages, which would have violated the requirement in Sections 104(b)(2) and 106(c) that any new ceiling be "higher."

low-cost old gas began to compete with higher-cost "new" and "hard-to-produce" gas, market forces ultimately would drive *overall* gas prices down. See pages 11-13, *supra*. As respondents concede (Br. in Opp. 9 n.5), the Commission's projection of lower overall prices has proven to be accurate. Although the price of old gas has risen in the short term (as the Commission expected when it issued Order No. 451), the national average wellhead price for *all* natural gas declined from $1.94 per Mcf in 1986 to $1.71 per Mcf in 1989. Energy Information Administration, Dep't of Energy, *Natural Gas Monthly*, at 32 (Table 4) (Mar. 1990).

2. The court of appeals did not attempt to refute either the Commission's exhaustive analysis and findings in Order No. 451 or the Commission's conclusion that the approach it adopted was just and reasonable under traditional NGA principles. In fact, the court expressly did *not* suggest that the Commission was "misguided" in concluding "that the disorder in the natural gas market has resulted, at least in part, from the NGPA's vintage pricing structure which compelled natural gas producers to sell gas at below replacement costs," Pet. App. 20a, and it grudgingly acknowledged that the Commission's solution to the pervasive problems besetting the natural gas industry as a result was "arguably meritorious." *Id.* at 23. But the court believed Congress had tied the Commission's hands and prevented it from implementing that solution.

In the court of appeals' view, Sections 104(b)(2) and 106(c) must be read to permit the Commission to adopt a higher price ceiling only in "narrow[]" circumstances where necessary to grant "special relief," such as where the rate permitted by the price ceiling would otherwise be confiscatory. Pet. App. 22a n.24. Nothing in those provisions supports the Court's crabbed construction. To the contrary, both Sections state that the Commission may prescribe a higher maximum lawful price "applicable to *any* first sale of natural gas" governed by those provisions, so long as the new ceiling is "just and reasonable." 15 U.S.C. 3314(b)(2), 3316(c) (emphasis

added). Congress's use of the word "any" makes clear that the Commission's regulatory jurisdiction over old gas prices is all-encompassing. Compare *United States* v. *Monsanto*, 109 S. Ct. 2657, 2662 (1989); *Public Employees Retirement System* v. *Betts*, 109 S. Ct. 2854, 2864 (1989). Moreover, because the single ceiling price the Commission selected in Order No. 451 had been found to be "just and reasonable" when it was first adopted in 1976, and because it has been adjusted regularly for inflation ever since, it is difficult to see how it could ever become confiscatory. Congress therefore must have had some purpose other than special relief in mind when it enacted Sections 104(b)(2) and 106(c).

In addition, as Judge Brown pointed out in dissent, the "sweeping nature" of Sections 104(b)(2) and 106(c) is also reflected in their authorization for the Commission to proceed "by rule or order." Pet. App. 48a. Since the "[e]xercise of this power is not confined to case-by-case rate making," it is "entirely appropriate for it to be used and employed generically." *Ibid.*[13] The broad scope of the Commission's discretion is further reinforced by the fact that both Sections permit a higher price ceiling for any "category" of old gas, "as determined by the Commission."

B. The Settled Judicial Construction Of The "Just And Reasonable" Standard When It Was Incorporated Into The Natural Gas Policy Act Strongly Supports The Commission's Revision Of The Vintage Pricing System For Old Gas

More fundamentally, the court of appeals' narrow construction of the Commission's authority under Sections 104(b)(2) and 106(c) wholly ignores the significance of the standard by which the Commission's exercise of its

[13] As Judge Brown also observed, Pet. App. 48a n.7, the Fifth Circuit previously had recognized, in a related context, that "[t]he drafters' choice of the words 'rule or order' * * * clearly contemplates the establishment of an industry-wide scheme." *Texas Eastern Transmission Corp.* v. *FERC*, 769 F.2d 1053, 1061 (5th Cir. 1985), cert. denied, 476 U.S. 1114 (1986).

authority is to be governed. As respondents concede (Br. in Opp. 19): "The 'just and reasonable' standard that Congress borrowed from the NGA and incorporated into the NGPA was familiar statutory language that carried with it a regulatory scheme well-known to Congress, the Commission, and the industry." Congress therefore must be understood to have intended that the "just and reasonable" standard would be interpreted in the same manner in the NGPA. See *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Curran*, 456 U.S. 353, 378-382 (1982); *Cannon* v. *University of Chicago*, 441 U.S. 677, 699 (1979); *Morissette* v. *United States*, 342 U.S. 246, 263 (1952).

1. As we have explained (see pages 3-5, *supra*), prior to enactment of the NGPA, the "just and reasonable" standard had been repeatedly construed by the Commission and the courts, including this Court, to accord the Commission a broad measure of flexibility and discretion. The court of appeals' construction of Sections 104(b)(2) and 106(c) to prohibit the Commission from departing from vintage pricing under the "just and reasonable" standard in those Sections cannot be reconciled with settled precedent.

For example, this Court had made clear since the earliest days of the NGA that the "just and reasonable" standard does not bind the Commission "to the use of any single formula or combination of formulae in determining rates" and that "[u]nder the statutory standard of 'just and reasonable,' it is the result reached not the method employed which is controlling." *Hope Natural Gas Co.*, 320 U.S. at 602; see also *FPC* v. *Natural Gas Pipeline Co.*, 315 U.S. 575, 586 (1942); *Wisconsin* v. *FPC*, 373 U.S. 294, 309 (1963); *Permian Basin*, 390 U.S. at 776-777; *FPC* v. *Texaco, Inc.*, 417 U.S. 380, 386-389 (1974).

These principles were given particular emphasis in decisions of this Court reviewing wellhead rates. In *Wisconsin* v. *FPC*, the Court held that the NGA's "just and reasonable" standard does not compel unwavering ad-

herence to the individual cost-of-service method of setting rates, and it did so in terms that are fatal to the court of appeals' view that the Commission cannot depart from the system of vintage pricing for old gas (373 U.S. at 309):

> [T]o declare that a particular method of rate regulation is so sanctified as to make it highly unlikely that any other method could be sustained would be wholly out of keeping with this Court's consistent and clearly articulated approach to the question of the Commission's power to regulate rates.

See also *Permian Basin*, 390 U.S. at 767, 800; *FPC* v. *Texaco*, 417 U.S. at 386-393.

What is more, prior to enactment of the NGPA, this Court had repeatedly sustained the Commission's authority to require *all* purchasers to bear part of the future costs of exploring for and developing additional reserves of natural gas—one of the principal justifications for the Commission's departure from vintage pricing in Order No. 451. Thus, in *Mobil Oil Corp.* v. *FPC*, the Court rejected the contention that the price previously established for the first vintage of gas from the Southern Louisiana producing area could not later be increased in the absence of evidence of increased costs (417 U.S. at 320):

> As between placing the burden of [expanding future production] on new or second vintage gas alone or spreading it over both old and new gas, [the Commission] judged the latter more equitable and more likely to lead to the immediately increased capital necessary in the face of a crisis. We see nothing * * * to suggest that the Commission could not * * * place the burden of those payments on all users rather than on those alone who purchased gas in the future.

See also *FPC* v. *Texaco Inc.*, 417 U.S. at 388 (encouraging exploration "obviously involve[s] the rate structure and implie[s] a broad discretion for the Commission"); *Permian Basin*, 390 U.S. at 797. This consideration has even greater force here, because the Commission deter-

mined that vintage pricing should be eliminated and higher rates allowed in order to encourage production of vast reserves of *old* gas that would otherwise go undeveloped.

Finally, the history of the vintage pricing scheme itself refutes the court of appeals' notion that it is an integral component of the "just and reasonable" standard incorporated into the NGPA for old gas. The Commission did not adopt vintage pricing until 1960—more than two decades after enactment of the NGA and its "just and reasonable" standard—and the Commission anticipated at the time that the vintage approach would be only a temporary measure and would be phased out when circumstances changed. See *Statement of General Policy*, No. 61-1, 24 F.P.C. 818, 819 (1960). In fact, as the Court noted in *Mid-Louisiana Gas*, the Commission, prior to enactment of the NGPA, had "shift[ed] from a pure historical-cost-based to an incentive-price-based approach, * * * and * * * temporarily abandon[ed] the practice of vintaging." 463 U.S. at 330 & n.10; see pages 5-6, *supra*. Both the Fifth and D.C. Circuits had upheld substantial modifications of the vintage pricing system (including the institution of replacement-cost methodology) against claims that they violated the "just and reasonable" standard of the NGA. See *Tenneco Oil Co.* v. *FERC*, 571 F.2d at 841-842, 847-848; *American Public Gas Ass'n* v. *FPC*, 567 F.2d at 1033-1034, 1057-1058; *Shell Oil Co.* v. *FPC*, 520 F.2d at 1077-1078; *Shell Oil Co.* v. *FPC*, 491 F.2d at 86-88. And just a few months prior to enactment of the NGPA, the Fifth Circuit approved a Commission order—which collapsed the pre-1973 vintages of "flowing gas" into a single category subject to a single ceiling price based on the historical costs incurred in the most recent (and highest-cost) test year—that is remarkably similar to the Order invalidated by the same court in this case. See *Tenneco Oil*, 571 F.2d at 837-838, 841-842; page 7, *supra*.

It is the vintage price ceilings sustained by *Permian Basin* and the court of appeals decisions just discussed

that Congress carried forward in Sections 104(b)(1) and 106(a) of the NGPA, expressly recognizing in the statutory text that each was a "*just and reasonable* rate * * * established by the Commission" under the NGA. 15 U.S.C. 3314(b)(1), 3316(a) (emphasis added). Congress therefore must have intended the Commission to have at least the same degree of discretion it was found to have in *Permian Basin* and the appellate decisions to revise the natural gas rates—including the vintage-pricing system—under the "just and reasonable" standard carried forward in Sections 104(b)(2) and 106(c).

2. The court of appeals' only response to Congress's explicit incorporation of the "just and reasonable" standard into Sections 104(b)(2) and 106(c) was to label the Commission's reliance on the plain meaning of that incorporation as "somewhat ingenious." Pet. App. 21a. But the court never suggested what that standard might mean if it does not confer the sort of flexibility and discretion that the Commission exercised here. It simply asserted that the system of multiple-vintage pricing in effect when Congress passed the NGPA was too "significant [a] feature of the NGPA's design" to be abrogated by the Commission, *id.* at 22a-23a, and thereby essentially read out of the NGPA the "just and reasonable" language upon which the Commission relied in consolidating all old gas into a single vintage.

Contrary to the court of appeals' view, however, although the various rates in effect in 1978 happen to have been based on a multiple-vintage approach to ratemaking, nothing in the NGPA suggests that it froze that particular approach (or the price ceilings it once yielded) for all time. Sections 104 and 106 in fact make no mention of vintage pricing or any other ratemaking methodology. They merely continue in effect the "just and reasonable *rate* * * * established by the Commission" for old gas, 15 U.S.C. 3314(b)(1), 3316(a) (emphasis added)—*i.e.*, the end result of the Commission's application of the vintage-pricing methodology it employed (albeit unevenly) during the early 1970's. See *Hope*

Natural Gas, 320 U.S. at 602. Because the just and reasonable standard does not require the Commission to follow any particular methodology in setting rates, Congress's decision to carry forward a particular "rate" (subject to a subsequent increase under the just and reasonable standard) does not imply that the underlying methodology has become part of the NGPA and therefore binding on the Commission.

At bottom, the court of appeals' refusal to give effect to the "just and reasonable" language Congress enacted was driven by the court's belief that "Congress' intent was, as it has been in the past, to protect the interests of consumers through incorporation of a vintaged old gas pricing scheme." Pet. App. 22a. But as we have just explained, the protection Congress afforded consumers derives not from a supposed incorporation of the vintaged-pricing scheme, of which there is no suggestion in the NGPA, but rather from Congress's express incorporation of the broad "just and reasonable" standard.

There is a deeper flaw, moreover, in the court of appeals' decision to construe Sections 104(b)(2) and 106(c) far more narrowly than their language permits in order to further what it understood to be Congress's "intent" to "protect the interests of consumers." The Court has recognized the dangers of that approach even where Congress has acted with a singular purpose: "[N]o legislation pursues its purposes at all costs. Deciding what competing values will or will not be sacrificed to the achievement of a particular objective is the very essence of legislative choice—and it frustrates rather than effectuates legislative intent simplistically to assume that *whatever* furthers the statute's primary objective must be the law." *Rodriguez* v. *United States*, 480 U.S. 522, 525-526 (1987). The point has even greater force here, because the "just and reasonable" standard has always been understood to require the Commission to consider a variety of interests, not merely those of consumers (or a particular group of consumers), in fixing or reviewing rates.

In any event, the court of appeals' premise that Sections 104 and 106 embody an unqualified commitment to maintaining the lowest possible prices for the particular pipelines and consumers that were fortunate enough to have access to ample supplies of old gas is refuted by the text of those Sections. Both Sections provide for *automatic* inflation adjustments in the ceiling price for old gas, whether or not the resulting increases are justified by the producer's historical costs. And both Sections authorize the Commission to adopt a different ceiling price only if it is *higher* than the one carried forward by the NGPA. If Congress was as single-minded in its determination to assure the lowest possible price as the court of appeals believed, it surely would have permitted the Commission to lower the ceiling prices in appropriate circumstances as well.

C. The Legislative History Does Not Support The Court Of Appeals' Interpretation Of Sections 104 And 106

The court of appeals attempted to avoid the force of the statutory text and its historical background by relying on isolated statements by several Members of Congress during the floor debates on the NGPA. Pet. App. 17a-20a & n.22. This Court has repeatedly stated, however, that "'[a]bsent a clearly expressed legislative intention to the contrary,' the words of the statute are conclusive." *Hallstrom* v. *Tillamook County*, 110 S. Ct. 304, 310 (1989) (quoting *CPSC* v. *GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980)). Here, the court of appeals pointed to no clearly expressed legislative intention suggesting that the term "just and reasonable" in Sections 104(b)(2) and 106(c) should be interpreted in a manner that departs so drastically from its settled meaning in the NGA.

The floor statements upon which the majority relied consist largely of general descriptions of the uncontroverted political compromises that led to enactment of the NGPA and of the NGPA's policies of protecting consumers while offering sufficient incentives for the pro-

duction of additional gas. Those statements—none of which specifically addressed the scope of the Commission's authority under Sections 104(b)(2) and 106(c)—are fully consistent with the Commission's approach in Order No. 451. The NGPA ultimately protects consumers of old gas not by permanently freezing whatever prices and pricing system happen to have been in effect for old gas at the time of enactment of the NGPA, but by carrying forward the "just and reasonable" standard of regulation that previously had been applied to the same gas under the NGA.

Moreover, as the Commission observed, 51 Fed. Reg. at 46,765 (J.A. 220), other portions of the NGPA's legislative history, which were not cited by the court below, demonstrate that Congress was aware of the broad and flexible authority vested in the Commission under the "just and reasonable" standard incorporated into Sections 104(b)(2) and 106(c) of the NGPA. For example, Senator Abourezk found it "critical to point out that [the NGA] does not require that the price set by the FERC be cost-based, except that, in the absence of full cost justification, the FERC must show the tangible benefits to consumers. This is the 'end result test' established in FPC against Hope Natural Gas Co." 124 Cong. Rec. 30,018 (1978). He also observed that "[n]othing prevents FERC setting the rates at whatever level is necessary actually to elicit new supply." *Ibid.* Senator Kennedy similarly observed that the Commission enjoyed the authority under the NGA "to establish prices which will bring forth gas at a 'just and reasonable' price and to vary that price according to conditions." *Id.* at 30,023.

The court of appeals' reading of the legislative history also ignores the origins of the "just and reasonable" standard in Sections 104(b)(2) and 106(c) as finally enacted. The bill passed by the House of Representatives would have extended controls for new gas, *Mid-Louisiana Gas*, 463 U.S. at 331, but would have effectively frozen the maximum lawful price of old natural gas on the basis of the applicable just and reasonable price established by the Commission as of April 1977 (as adjusted

for inflation). The House bill contained no provision for subsequent increases in the price ceiling for old gas; a producer could collect a higher price only under a special relief provision for high-cost gas.[13] By contrast, the bill passed by the Senate would have deregulated new gas in the near future, but "would have maintained Natural Gas Act regulation for all gas sold or delivered in interstate commerce before January 1, 1977." *Mid-Louisiana Gas*, 463 U.S. at 331.[14] Under the Senate bill, the Commission plainly would have retained the authority it had under the NGA's "just and reasonable" standard to abandon vintage pricing. The bill reported by the Conference Committee and enacted into law was a hybrid: it incorporated from the House bill the concept of statutory price ceilings for old gas based on the just and reasonable rates established by the Commission in April 1977, but it incorporated from the Senate bill the retained power of the Commission to modify those ceilings (but only to make them higher) under the just and reasonable standards of the NGA. Thus, Congress rejected an approach to regulation of old gas that would have frozen prices in the way the court of appeals construed Sections 104(b)(2) and 106(c) to require. The court, in short, "read too much into * * * scattered bits of legislative history." *Pennhurst State School* v. *Halderman*, 451 U.S. 1, 20 (1981).

II. THE COMMISSION WAS AUTHORIZED BY SECTION 7(b) OF THE NATURAL GAS ACT TO SPECIFY IN ORDER NO. 451 THE CIRCUMSTANCES UNDER WHICH FUTURE ABANDONMENT OF GAS SERVICE IS PERMITTED

The court of appeals also erred in invalidating the abandonment provision of Order No. 451, which is an integral component of the Good Faith Negotiation (GFN)

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[13] H.R. 8444, 95th Cong., 1st Sess. §§ 405, 409 (1977), 123 Cong. Rec. 26,169 (1977); see H.R. Rep. No. 496, 95th Cong., 1st Sess. Pt. 4, at 104-106 (1977).

[14] See S. 2104, 95th Cong., 1st Sess. § 3 (1977), as amended, 123 Cong. Rec. 32,306 (1977).

procedure and, indeed, of the entire rulemaking package. Pet. App. 24a-28a. Under Order No. 451, a producer may abandon its service obligation to the purchaser under an existing contract only if the purchaser elects not to continue buying the gas in question, and only if the producer has entered into a contract to sell the same gas to another purchaser, which ensures that the gas will remain in the interstate market. See pages 14-15, *supra*. The Commission reasonably concluded that where these conditions are satisfied among the parties directly concerned, the producer should be permitted to abandon its service obligations to the prior customer so that it may begin to serve its new customer.

The NGPA "comprehensively and dramatically" changed the wellhead price regulation of natural gas sales. *Mid-Louisiana Gas*, 463 U.S. at 322. The NGPA did not, however, relieve the Commission of its responsibility under the NGA to regulate the non-price features of most old gas sales. Of particular relevance here, the NGPA left unaltered the requirement in Section 7(b) of the NGA, 15 U.S.C. 717f(b), that natural gas, once "committed or dedicated" to interstate commerce, must continue to flow in interstate commerce until the Commission authorizes the "abandonment" of that service. Specifically, Section 7(b) provides that "[n]o natural-gas company shall abandon * * * any service * * * without the permission and approval of the Commission first had and obtained, after due hearing, and a finding by the Commission * * * that the present or future public convenience or necessity permit such abandonment." Order No. 451 complies with these express requirements of Section 7(b) in every respect. The Commission so concluded after thoroughly considering the scope of its Section 7(b) authority when it issued Order No. 451. See 51 Fed. Reg. at 22,171-22,172, 22,205-22,206, 46,785-46,787 (J.A. 21-23, 147-149, 301-309). That reasonable interpretation of the NGA by the agency charged with its administration is entitled to considerable deference.

A. In Order No. 451, the Commission expressly gave the "permission and approval" required by Section 7(b)

for the abandonments of service covered by the Order, although it conditioned its approval upon the future occurrence of several protective conditions: (1) the inability of the producer and the purchaser to reach agreement on a revised price for old gas within the framework of the GFN procedure; (2) the producer's execution of a new contract to sell the released gas to a new purchaser; and (3) the purchaser's receipt of at least thirty days' notice of contract termination. See 18 C.F.R. 270.201(c)(1), (e)(3) and (4), and (f)(5). This Court specifically held in *FPC* v. *Moss*, 424 U.S. 494 (1976), that Section 7(b) authorizes the Commission to give advance approval of an abandonment.[18]

B. The Commission also made the requisite findings under Section 7(b) that, within the context of Order No. 451 as a whole, the "present and future public interest or necessity permit [such] abandonment." 51 Fed. Reg. at 46,785-46,787 (J.A. 301-306). First, the abandonment provision is but one feature of the Good Faith Negotiation procedure, which was designed to serve the public interest by protecting purchasers of gas under contracts having indefinite price-escalation clauses against the automatic price increases they otherwise would experience as a result of Order No. 451's higher price ceiling for old gas. The right of the producer to abandon service if the parties cannot reach agreement on a new price prevents the purchaser from exploiting the special protection afforded it by the GFN procedure by refusing to bargain in good faith.

The Commission further concluded that where the producer and purchaser cannot reach agreement under the GFN procedure for the continued sale of gas at a new price, the public interest would be served by making

[18] The court of appeals was mistaken in believing that the abandonment provisions of Order No. 451 conflict with *United Gas Pipe Line Co.* v. *McCombs*, 442 U.S. 529 (1979). Pet. App. 27a. There, the Commission had failed altogether to give its "permission and approval" for the abandonment at issue, and therefore it had not made an express finding that the public convenience or necessity favored that abandonment.

prompt provision for the sale of that gas to another purchaser, in order to ensure that the public will have adequate supplies of natural gas.[19] This finding represents a legitimate application of the Commission's policy that the propriety of abandonment depends upon a comparison of the individual needs of current gas consumers being served by the gas reserves against the overall needs of the natural gas market in seeing that those reserves remain dedicated to interstate commerce. 51 Fed. Reg. at 46,786 (J.A. 303-306); see *Consolidated Edison Co. of New York* v. *FERC*, 823 F.2d 630, 632 (D.C. Cir. 1987) ("the statutory 'public convenience or necessity' language frees [the Commission] to develop new policies to accommodate a shifting energy marketplace"); *Felmont Oil Corp.*, 33 F.E.R.C. ¶ 61,333, at 61,657 (1985), rev'd on other grounds *sub nom. Consolidated Edison Co.* v. *FERC*, 823 F.2d 630 (D.C. Cir. 1987). As Judge Brown aptly noted in his dissent, "Order No. 451 would be a meaningless exercise if, despite the Commission's finding that the vintage pricing system was unjust and unreasonable, pipelines with dominant market power could nevertheless effectively nullify GFN and shut in the gas or otherwise prevent increased supplies from reaching the market at a competitive price." Pet. App. 52a. By the same token, the Commission concluded that "generally a purchaser's loss of gas under abandonment provisions of the good faith negotiation rule should not cause it, or the market it serves, to experience a shortage of supply," because in light of

[19] The Commission summarized these points on rehearing (51 Fed. Reg. at 46,785 (J.A. 302)):

> [A]bandonment under the good faith negotiation rule is in the public interest, since it is necessary to ensure that the goals of Order No. 451 of increased production of old gas and overall lower prices * * * are achieved. These goals cannot be achieved unless producers can obtain the market-responsive prices permitted by the rule. Without the possibility of abandonment, purchasers under existing contracts could prevent producers from obtaining those prices by insisting on continuation of the present price.

market-responsive prices of new gas and the elimination of shortages, purchasers should have no difficulty finding alternative sources of supply. 51 Fed. Reg. at 46,786 (J.A. 304).

The court of appeals nevertheless believed that the GFN process and the conditions for abandonment are "one-sided" and producer-oriented. Pet. App. 24a n.26, 28a, 31a-32a. The court failed to appreciate the purchaser's decisive role in the GFN process and the circumstances that trigger it. First, the GFN procedure was included in the Order to protect *purchasers* from the consequences of automatic price-escalation clauses. Second, once the GFN process is triggered, if the purchaser signals an intent to continue to purchase old gas at a mutually agreed-upon price, the producer cannot "unilaterally" abandon sales. See *id.* at 59a (Brown, J., dissenting) (recognizing that the GFN process affords pipeline-purchasers "substantial bargaining leverage"). Third, the purchaser may often realize substantial benefits under the GFN process, because it has an opportunity to reopen the price terms of any contract with the producer that involves the sales of some old gas, including contracts that expose the purchaser to take-or-pay liability. Fourth, the purchaser has an important reciprocal right that corresponds to the producer's right of abandonment: once the produced triggers the GFN process, the purchaser has the right to terminate any contracts between the parties that cover at least some old gas, if the parties do not reach agreement on a new price to be paid for gas under them. For these reasons, the court's concerns about the fairness of the GFN and abandonment process are unfounded and do not undermine the Commission's "public interest or necessity" determination.

C. Finally, the Commission's grant of permission to abandon contract service in the circumstances specified in Order No. 451 is fully consistent with the phrase "after due hearing" in Section 7(b). The court below cited that phrase in support of its conclusion that Section 7(b) requires the Commission to conduct "case specific" inquiries into the merits of each individual aban-

donment application. Pet. App. 26a-28a. As the Commission observed when it issued Order No. 451, however, a regime of individualized hearings would cause administrative backlogs and substantial delays in achieving the benefits of increased production and lower overall prices. 51 Fed. Reg. at 46,785-46,786 (J.A. 302). It also would detract from the negotiations that the GFN feature of the Order was designed to facilitate. Section 7(b) does not require that Order No. 451 be burdened with such self-defeating procedures.

The courts consistently have held that an individualized administrative hearing is "due" only when there are disputed issues of material and historical fact that bear on the resolution of the matter to be decided. By contrast, legislative-type facts and questions of policy—such as those underlying the pricing, GFN, abandonment and other provisions of Order No. 451—may be resolved through rulemaking and need not be addressed again on a case-by-case basis. See, *e.g.*, *Heckler* v. *Campbell*, 461 U.S. 458, 467 (1983); *Permian Basin*, 390 U.S. at 774-777; *FPC* v. *Texaco, Inc.*, 377 U.S. 33, 41-44 (1964). The rulemaking proceeding itself is the only hearing that is "due" on those questions, and respondents were given a full opportunity to participate in that proceeding. See 51 Fed. Reg. at 46,786-46,787 (J.A. 304-309). Having determined at the conclusion of those rulemaking proceedings that the myriad relevant factors justified the higher price ceiling it adopted in Order No. 451 from the perspective of the natural gas market as a whole, the Commission was not required to relitigate the wisdom of those statutory policy judgments as applied to the circumstances of each contract between a producer and pipeline.

The apparent conclusion by the court below that the term "due hearing" in Section 7(b) requires precisely that sort of individualized hearing not only conflicts with the foregoing principles, it also is inconsistent with a line of D.C. Circuit decisions that have sustained the Commission's approach. In *Associated Gas Distributors* v. *FERC*, 824 F.2d 981 (1981), cert. denied, 485 U.S. 1006 (1988), that court upheld the relevant provisions of

the Commission's comprehensive regulations permitting interstate pipelines in certain circumstances to abandon their contractual obligation to provide sales service when pipeline customers choose to "convert" from sales service to firm transportation service. 824 F.2d at 1013-1016. The court concluded that there is "no procedural objection to the Commission's identification of circumstances, in an otherwise valid rulemaking, which automatically trigger its approval of abandonment (*i.e.*, establish a system of 'pre-granted' abandonment approval)." *Id.* at 1015 n.17. Similarly, in *Kansas Power & Light Co.* v. *FERC*, 851 F.2d 1479, 1483-1486 (1988), the D.C. Circuit upheld the Commission's authorization of pre-granted "limited term abandonment" against the claim that the "due hearing" language found in Section 7(b) of the NGA necessarily requires a trial-type evidentiary hearing. And in *Panhandle Eastern Pipe Line Co.* v. *FERC*, No. 89-1354 (D.C. Cir. June 29, 1990), the court reiterated that "the Commission may use a rulemaking to identify circumstances where the public interest will be served by a particular consent," and then, where appropriate, limit the scope of later adjudications to whether those circumstances are present. Slip op. 5 (citing *Heckler* v. *Campbell*, 461 U.S. at 467)."[17] Under Order No. 451, if a purchaser objects to a proposed abandonment on the ground that the conditions specified in the Order as prerequisites to receiving the Commission's approval are not present, it may, of course, challenge the producer's proposed action by filing a complaint with the Commission. See 18 C.F.R. 385.206. But where those conditions are present, the Commission has reasonably concluded that its "permission and approval" of the abandonment should be granted, in furtherance of the policies of Order No. 451 as a whole.

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[17] The D.C. Circuit also expressly "disagree[d]" with the decision of the court below in this case, "[t]o the extent that the *Mobil* court reads *United Gas Pipe Line Co.* v. *McCombs*, 442 U.S. 529 (1976), as barring *any* provision for generic, pre-granted abandonment." Slip op. 6.

III. THE COMMISSION WAS NOT REQUIRED TO IMPLEMENT A COMPREHENSIVE SOLUTION TO THE "TAKE-OR-PAY" PROBLEM IN CONNECTION WITH ORDER NO. 451 BEFORE RAISING THE CEILING PRICE FOR OLD GAS

The court of appeals' errors in this case were not limited to its construction of Sections 104(b)(2) and 106(c) of the NGPA and Section 7(b) of the NGA. It also strayed far afield into a discussion of the "take-or-pay" problem, and seemed to be of the view that the Commission should have implemented a comprehensive solution to that problem before raising the price of old gas under Order No. 451. See Pet. App. 29a-32a.

Over the last several years, both the Commission and the natural gas industry have grappled with the issues arising from "take-or-pay" clauses found in sales contracts between producers and pipelines. A "take-or-pay" clause typically obligates a pipeline to purchase a specified volume of gas at a specified price and, in the event it is unable to do so, to pay for that volume. See *Transco*, 474 U.S. at 412. Most of these contracts were executed between 1977 and 1982, years marked by serious natural gas shortages and high natural gas prices. See generally Pet. App. 29a-30a; *Associated Gas Distributors* v. *FERC*, 824 F.2d at 1021. Market conditions changed dramatically in the 1980s, however, upsetting the expectations of parties to take-or-pay contracts. Natural gas shortages of the type that led to the enactment of the NGPA gave way to a market characterized by gas oversupply, reduced gas demand, and lower gas rates. Many pipelines subsequently found themselves unable to take enough gas under high-cost take-or-pay contracts to avoid substantial take-or-pay liabilities, which were cumulatively worth many billions of dollars.

After explaining the magnitude of the take-or-pay problem, Pet. App. 29a-30a, the court of appeals expressed the belief that the Commission had failed to address it. Then, characterizing that supposed inaction as both "regrettable and unwarranted," the court appeared to require the Commission to address and solve the take-or-pay problem as a condition precedent to the lawful

promulgation of Order No. 451. See *id.* at 31a-32a. If the court of appeals did intend this to be an independent ground for invalidating Order No. 451, it clearly overstepped the bounds of judicial review.

The first error in what Judge Brown understood to be the majority's direction to the Commission "to consider, and once and for all to *solve*," the problem of take-or-pay contracts (Pet. App. 57a-58a (Brown, J., dissenting)) lies in its failure to appreciate that the Commission in fact has devoted great attention to the take-or-pay problem. Specifically, in combination with its efforts to induce a more competitive market, the Commission initiated rulemaking proceedings, primarily concerning Order Nos. 436 and 500, that were intended to reduce overall take-or-pay liabilities and to allocate take-or-pay costs equitably among all levels of the natural gas industry.[18] Those efforts are described in detail in our petition for a writ of certiorari (at 4-13) in *FERC* v. *Associated Gas Distributors*, petition for cert. pending, No. 89-2016 (filed June 22, 1990), in which we seek review of the D.C. Circuit's invalidation of one of the Commission's central initiatives to that end. The Commission's "equitable sharing" approach thus far has been quite successful in promoting resolution of take-or-pay liability between pipelines and producers, resulting in settlements reducing current and future pipeline take-or-pay liability by a total of approximately $44 billion. Those

[18] Order No. 436, *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, 50 Fed. Reg. 42,408 (1985), 1982-1985 FERC Stats. & Regs. [Regs. Preambles] (CCH) ¶ 30,665 (1985), aff'd in part and remanded in part *sub nom. Associated Gas Distributors* v. *FERC*, 824 F.2d 981 (D.C. Cir. 1987), cert. denied, 485 U.S. 1006 (1988). The Commission subsequently repromulgated Order No. 436, with certain revisions, as Order No. 500, 52 Fed. Reg. 30,334 (1987), FERC Stats. & Regs. [Regs. Preambles] (CCH) ¶ 30,761 (1987), record remanded *sub nom. American Gas Ass'n* v. *FERC*, 888 F.2d 136 (D.C. Cir. 1989). Following the remand, the Commission issued Order No. 500-H, 54 Fed. Reg. 52,344 (1989), FERC Stats. & Regs. [Regs. Preambles] (CCH) ¶ 30,867 (1989), on reh'g, Order No. 500-I, FERC Stats. & Regs. [Regs. Preambles] (CCH) ¶ 30,880 (1990), petitions for review pending *sub nom. American Gas Ass'n* v. *FERC*, No. 87-1588 (D.C. Cir. argued May 8, 1990).

settlements have come at a cost to the pipelines of approximately $9 billion, much of which has been passed on to pipeline customers under the equitable sharing approach. 89-2016 Pet. 11, 17, 28-29.[19] The court of appeals' belief that nothing has been done to address the take-or-pay problem therefore is completely without foundation.[20]

The court below also erred in believing that the Commission was insensitive to the take-or-pay issue when it adopted Order No. 451. The Commission did not purport to offer a comprehensive solution to that problem in Order No. 451, since, as it pointed out at the time, take-or-pay issues were already being addressed head-on in separate proceedings. 51 Fed. Reg. at 22,174-22,175, 22,196, 46,783-46,784 (J.A. 33-37, 120-121, 292-295). But the Commission did take the take-or-pay problem into account in fashioning Order No. 451. In fact, the Commission specifically intended the GFN procedure established by the Order to encourage the settlement of take-or-pay disputes and the renegotiation of "mixed" contracts for the sale of both old gas and high-cost gas. *Id.* at 22,196-22,197 (J.A. 120-122). The court of appeals was of the view that the GFN procedure is "one-sided" and fails to give pipelines sufficient leverage. Pet. App. 31a. As we have explained (see page 42, *supra*), the court was wrong. See also Pet. App. 59a (Brown, J., dissenting) (noting the "substantial bargaining leverage" thus provided to pipelines). In any event, this is precisely the sort of question on which a court should not substitute its judgment for that of the expert agency charged by Congress with making that very sort of prediction. And as it turned out, the Department of Energy reported to Congress during its consideration of the Na-

[19] See Order No. 500-H, *supra*, FERC Stats. & Regs. at 31,522-31,523.

[20] This error by the court below is all the more remarkable because it previously recognized in *Transwestern Pipeline Co.* v. *FERC*, 820 F.2d 733, 744 (5th Cir. 1987), cert. denied, 484 U.S. 1005 (1988), that the "take-or-pay issue" is a "separate matter which is being addressed in other proceedings" and that "[t]he Commission is not ignoring the issue."

tural Gas Wellhead Decontrol Act of 1989, discussed below, that take-or-pay issues were resolved in 33% of the large-producer contracts that were renegotiated pursuant to or in light of Order No. 451.[21]

Of course, Order No. 451 could not offer a comprehensive resolution of all outstanding take-or-pay liabilities (particularly those involving new gas), since it was directed primarily to the distinct issue of price ceilings for old gas. Our point is simply that, on its own terms, Order No. 451 did address the issue.

In these circumstances, the court of appeals plainly erred to the extent it sought to direct the Commission to reorder its regulatory priorities so as to address and solve the take-or-pay problem in the context of raising the price ceilings for old gas—most of which is not subject to the take-or-pay contracts that were entered into between 1977 and 1982. This Court has made clear that an agency has exceedingly broad discretion to determine the proper ordering of its priorities and to select appropriate vehicles for addressing those priorities. In *Vermont Yankee Nuclear Power Corp.* v. *NRDC, Inc.*, 435 U.S. 519 (1978), the Court held that it is "absolutely clear" that "[a]bsent constitutional constraints or extremely compelling circumstances the 'administrative agencies "should be free to fashion their own rules of procedure and to pursue methods of inquiry capable of permitting them to discharge their multitudinous duties."'" *Id.* at 543-544 (quoting *FCC* v. *Schreiber*, 381 U.S. 279, 290 (1965)). Indeed, in *FPC* v. *Sunray DX Oil Co.*, 391 U.S. 9 (1968), the Court, applying the same general principles, explicitly affirmed the discretion of the Commission to address take-or-pay issues in proceedings of the Commission's own choosing, namely, pipeline proceedings rather than producer proceedings. *Id.* at 49-52.[22]

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[21] See *Natural Gas Price Controls: Hearing on H.R. 1595 Before the Subcomm. on Energy and Power of the House Comm. on Energy and Commerce*, 101st Cong., 1st Sess. 158-159 (1989).

[22] See also *FPC* v. *Transcontinental Gas Pipe Line Corp.*, 423 U.S. 326, 333 (1976) (Commission should be permitted to "exercise its administrative discretion in deciding how, in light of internal

Under these principles, the court of appeals had no authority to direct the Commission to address the take-or-pay problem in the Order No. 451 proceeding, "under penalty of forfeiting its judgmental conclusion on increased price for old gas [and] abandonment." Pet. App. 58a (Brown, J., dissenting). Certainly nothing in Sections 104(b)(2) and 106(c) of the NGPA authorizes a court to impose such a condition precedent. Those Sections authorize the Commission to raise the ceiling price of "*any* first sale of *any* natural gas," 15 U.S.C. 3314 (b)(2), 3316(c) (emphasis added), without regard to whether that gas (or other gas covered by a contract between the same producer and purchaser) is subject to a take-or-pay clause.

IV. CONGRESS'S ENACTMENT OF THE WELLHEAD DECONTROL ACT CONFIRMS THE SOUNDNESS OF ORDER NO. 451

The soundness of Order No. 451 under the NGPA standing alone is reinforced by the basis on which Congress passed the Wellhead Decontrol Act of 1989, which lifts controls on wellhead sales of natural gas effective January 1, 1993. Pub. L. No. 101-60, § 2(b), 103 Stat. 158. In its deliberations on that Act, Congress recognized that "[c]hanges in the natural gas industry and in the framework for Federal natural gas regulation that have occurred over the past decade * * * make the repeal of remaining wellhead controls appropriate." S. Rep. No. 39, 101st Cong., 1st Sess. 5 (1989). Among the Commission actions cited by Congress in this regard was Order No. 451, which Congress believed would function essentially as a transitional device between the NGPA and decontrol. *Id.* at 5-6; H.R. Rep. No. 29, 101st Cong., 1st Sess. 6 (1989).

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organization considerations, it may best proceed to develop * * * the methods, procedures, and time dimension of the needed inquiry"); *Wisconsin Gas Co.* v. *FERC*, 770 F.2d 1144, 1159-1160 (D.C. Cir. 1985) ("for the reviewing court to maintain its proper function, it cannot require agencies to solve all problems that may be related to a particular decision at the same time"), cert. denied, 476 U.S. 1114 (1986).

Moreover, Congress recognized in enacting the Wellhead Decontrol Act that "[t]hrough [Commission] initiatives, more competition in the interstate pipeline industry has brought lower prices to all consumers, including captive residential consumers," and it premised the future decontrol of natural gas on its disapproval of many of the same market conditions and other factors the Commission sought to address in promulgating Order No. 451. H.R. Rep. No. 29, *supra*, at 3-4, 5-7; S. Rep. No. 39, *supra*, at 3-6. Congress further recognized that as a result of the Commission's initiatives, "[w]hile about one-third of our supplies are still controlled, most of those controls are well above market levels," and only about 5% of the nation's total gas supply was still subject to price controls at below-market levels. H.R. Rep. No. 29, *supra*, at 3-4; S. Rep. No. 39, *supra*, at 3. In short, Congress's decision to proceed with wellhead decontrol because of its approval of what the Commission had accomplished administratively confirms the Commission's considered judgment that the elimination of the vintage-pricing system in Order No. 451 (along with other measures to promote competition in the natural gas industry) comports with both the policies of the NGPA and the long-term interests of consumers.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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APPENDIX

STATUTORY AND REGULATORY PROVISIONS INVOLVED

A. RELEVANT STATUTORY PROVISIONS

1. Section 4(a) of the Natural Gas Act of 1938, as codified at 15 U.S.C. 717c(a), provides:

(a) Just and reasonable rates and charges

All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is declared to be unlawful.

2. Section 5(a) of the Natural Gas Act of 1938, as codified at 15 U.S.C. 717d(a), provides:

§ 717d. Fixing rates and charges; determination of cost of production or transportation

(a) Decreases in rates

Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State commission, or gas distributing company, shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, un-

duly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order: *Provided, however,* That the Commission shall have no power to order any increase in any rate contained in the currently effective schedule of such natural gas company on file with the Commission, unless such increase is in accordance with a new schedule filed by such natural gas company; but the Commission may order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates.

3. Section 7(b) of the Natural Gas Act of 1938, as codified at 15 U.S.C. 717f(b), provides:

(b) Abandonment of facilities or services; approval of Commission

No natural-gas company shall abandon all or any portion of its facilities subject to the jurisdiction of the Commission, or any service rendered by means of such facilities, without the permission and approval of the Commission first had and obtained, after due hearing, and a finding by the Commission that the available supply of natural gas is depleted to the extent that the continuance of service is unwarranted, or that the present or future public convenience or necessity permit such abandonment.

4. Section 104 of the Natural Gas Policy Act of 1978, as codified at 15 U.S.C. 3314, provides:

§ 3314. Ceiling price for sales of natural gas dedicated to interstate commerce

(a) Application

In the case of natural gas committed or dedicated to interstate commerce on November 8, 1978, and

for which a just and reasonable rate under the Natural Gas Act [15 U.S.C. 717 et seq.] was in effect on such date for the first sale of such natural gas, the maximum lawful price computed under subsection (b) of this section shall apply to any first sale of such natural gas delivered during any month.

(b) Maximum lawful price

(1) General rule

The maximum lawful price under this section for any month shall be the higher of—

(A)(i) the just and reasonable rate, per million Btu's, established by the Commission which was (or would have been) applicable to the first sale of such natural gas on April 20, 1977, in the case of April 1977; and

(ii) in the case of any month thereafter, the maximum lawful price, per million Btu's, prescribed under this subparagraph for the preceding month multiplied by the monthly equivalent of the annual inflation adjustment factor applicable for such month, or

(B) any just and reasonable rate which was established by the Commission after April 27, 1977, and before November 9, 1978, and which is applicable to such natural gas.

(2) Ceiling prices may be increased if just and reasonable

The Commission may, by rule or order, prescribe a maximum lawful ceiling price, applicable to any first sale of any natural gas (or category thereof, as determined by the Commission) otherwise subject to the preceding provisions of this section, if such price is—

(A) higher than the maximum lawful price which would otherwise be applicable under such provisions; and

(B) just and reasonable within the meaning of the Natural Gas Act [15 U.S.C. 717 et seq.].

5. Section 106 of the Natural Gas Policy Act, as codified at 15 U.S.C. 3316, provides in pertinent part:

§ 3316. Ceiling price for sales under rollover contracts

(a) Interstate rollover contracts

In the case of the first sale under any rollover contract of natural gas which was committed or dedicated to interstate commerce on November 8, 1978, the maximum lawful price under this subsection for such natural gas delivered during any month shall be the higher of—

(1) (A) in any case of the month in which the effective date of such rollover contract occurs, the just and reasonable rate, if any, per million Btu's, established by the Commission and applicable on such date to the natural gas subject to the expired contract; and

(B) in the case of any month thereafter, the maximum lawful price, per million Btu's, prescribed under this paragraph for the preceding month multiplied by the monthly equivalent of the annual inflation adjustment factor applicable for such month; or

(2) (A) $0.54 per million Btu's, in the case of April 1977; and

(B) in the case of any month thereafter, the maximum lawful price, per million Btu's, prescribed under this paragraph for the preceding month multiplied by the monthly equivalent of the annual inflation adjustment factor applicable for such month. For purposes of this subsection, the term "rollover contract" includes any contract which would have been a rollover contract but for the fact that the expiration of the previous contract occurred prior to November 8, 1978.

(b) Intrastate rollover contracts

(1) General rule

In the case of any first sale under any rollover contract of natural gas which was not committed or dedicated to interstate commerce on November 8, 1978, the maximum lawful price under this subsection for such natural gas delivered during any month shall be the higher of—

(A) (i) the maximum price paid under the expired contract, per million Btu's, in the case of the month in which the effective date of such rollover contract occurs; and

(ii) in the case of any month thereafter, the maximum lawful price, per million Btu's, prescribed under this subparagraph for the preceding month multiplied by the monthly equivalent of the annual inflation adjustment factor applicable for such month; or

(B) (i) $1.00 per million Btu's, in the case of April 1977; and

(ii) in the case of any month thereafter, the maximum lawful price, per million Btu's, prescribed under this subparagraph for the preceding month multiplied by the monthly equivalent of the annual inflation adjustment factor applicable for such month.

(2) Certain State or Indian production or royalty shares

* * * * *

(c) Ceiling price may be increased if just and reasonable

The Commission may, by rule or order, prescribe a maximum lawful price, applicable to any first sale of any natural gas (or category thereof, as determined by the Commission) otherwise subject to the preceding provisions of this section, if such price is—

(1) higher than the maximum lawful price which would otherwise be applicable under such provisions; and

(2) just and reasonable within the meaning of the Natural Gas Act [15 U.S.C. 717 et seq.].

B. RELEVANT REGULATORY PROVISIONS ADOPTED BY ORDER NO. 451, AS AMENDED

1. 18 C.F.R. 157.301 provides:

§ 157.301 Blanket certificate authority, pregranted abandonment, and reporting requirements.

(a) *Blanket certificate authority.* Any first seller of natural gas that is authorized to abandon the sale of gas under § 157.30 (c) or (d) or the good faith negotiation procedures set forth in § 270.201 of this chapter, is granted a certificate of public convenience and necessity to sell such gas for resale in interstate commerce, subject to the reporting requirements of paragraph (c) of this section.

(b) *Pre-granted abandonment.* Any first seller who sells natural gas under the blanket certificate authority of paragraph (a) of this section is authorized to abandon the sale upon termination of the contract under which the sale is made.

(c) *Reporting requirement.* Any first seller who makes sales under the blanket certificate authority of this section must file a report with the Commission not later than April 1 of each year providing the following information with respect to any sales under that certificate initiated during the preceding calendar year:

(1) Name of former purchaser;

(2) Name of new purchaser;

(3) Location of sale (field, block, county, state, etc.);

(4) Contract date;

(5) Contract term;

(6) Average price; and

(7) Estimated annual sales volume (mcf).

(d) *Waiver of rate filing requirements.* The rate filing requirements of §§ 154.92 and 154.94 of this chapter are waived for sales under a certificate granted by this section.

2. 18 C.F.R. 270.201 provides:

§ 270.201 Good faith negotiation procedures.

(a) *Applicability definitions, and general rules.* (1) This section applies to requests for renegotiation of the price of old gas sold under an existing contract.

(2) For purposes of this section:

(i) "Old gas" means natural gas which, if sold, would be subject to a maximum lawful ceiling price under section 104 or 106(a) of the NGPA.

(ii)(A) "Existing contract" means a contract in effect on July 18, 1986, or an expired contract pursuant to which sales of natural gas are continuing on that date under the service obligation of a certificate of public convenience and necessity, that includes the sale of any old gas and provides authority for the first seller to collect a higher price upon establishment by the Commission of a higher maximum lawful price.

(B) An existing contract includes the sale of old gas if, on July 18, 1986, the contract encompasses

the sale of any gas that has not been abandoned under section 7(b) of the Natural Gas Act and which, if sold, would be priced as old gas, whether or not any old gas is sold on that date.

(iii) The terms "first seller" and "party to a contract" include:

(A) An owner of a working interest in an oil or gas lease that has a direct contractual relationship with a purchaser for a "first sale" of gas, as defined in section 2(21) of the NGPA; and

(B) An operator of an oil or gas lease that has a direct contractual relationship with a purchaser for a "first sale" on behalf of any owner of a working interest in the lease that does not have such a relationship.

(3)(i) Any existing contract under which old gas is sold may be renegotiated or amended at any time to provide for a price up to the alternative maximum lawful price under § 271.402(c)(7)(i) of this chapter without using the good faith negotiation procedures.

(ii) A price for old gas that exceeds the otherwise applicable maximum lawful price under § 271.402 of this chapter may be collected under an existing contract only if the first seller and purchaser agree upon a price up to the alternative maximum lawful price under § 271.402(c)(7)(ii) in accordance with this section.

(4) A party to an existing contract may not request a nomination of a price under the provisions of this section for any gas sold under the contract if that party:

(i) And the purchaser or first seller have renegotiated the price or any other term for the sale of any old gas under the contract after July 18, 1986, without using the good faith negotiation procedures of this section, and have not agreed in writing to preserve their rights under this section:

(ii) Has previously requested nomination of a price under paragraph (b)(1) of this section for any gas sold under the contract; or

(iii) Has been requested under this section to nominate a price for any gas sold under the contract, and the last date has passed under paragraphs (b)(2) or (b)(3) of this section to request the other party to nominate a price for gas sold under the contract.

(5)(i) A first seller that validly assigns or otherwise transfers gas subject to an existing contract on or after June 3, 1987 may not request a nomination of price under the provisions of this section for any gas sold under any existing contract with that purchaser unless the purchaser's right to renegotiate, under the provisions of this section, the terms of sale of the assigned gas are unaffected by the assignment.

(ii) A first seller to whom gas subject to an existing contract is validly assigned, or otherwise transferred, on or after June 3, 1987 may not request nomination of a price under the provisions of this section for the assigned gas, unless the purchaser's right to renegotiate, under the provisions of this section, the terms of sale of all gas sold under any existing contract between the purchaser and the assignor on June 3, 1987 are unaffected by the assignment.

(6) Any request for nomination of a price under this section, any nomination of a price in response to such a request, and any notice of abandonment of sales or termination of purchases under this section must be sent by U.S. mail, return receipt requested.

(7) Any deadline under this section for requesting a nomination of a price, or for nominating a price in response to such a request, may be extended by mutual agreement of the parties in writing. Any notice required under this section to be given before a first seller or purchaser abandons or terminates

sales or purchasers may be shortened by mutual agreement of the parties in writing.

(8) A party nominating a price may propose a change in any other terms of the existing contract, and for purposes of this section, the terms "nominated price" and "nomination" may include such a proposed change.

(b) *Requests for negotiation and nomination of price.*

(1) (i) At any time after January 23, 1987, a first seller may request the purchaser to nominate a price at which the purchaser is willing to continue buying old gas under any existing contract by submitting a written request to the purchaser, and may specify the wells or category of wells under each contract for which the first seller requests a renegotiated price.

(ii) When requesting a nomination of a price under this paragraph, a first seller may also request the purchaser to provide the first seller with a current list of all of the purchaser's firm sales customers, including the name and address of an employee or agent responsible for negotiating purchases of natural gas on behalf of the customer. The purchaser must send the list of customers to the first seller within 30 days after receiving the request and must include a certification of its completeness and accuracy. The list must be sent by U.S. mail, return receipt requested.

(2) Within 30 days after receiving a request for nomination of a price under paragraph (b)(1) of this section, the purchaser may request the first seller to nominate a price at which the first seller is willing to continue selling any gas, including old gas for which the first seller has requested a nomination of price by the purchaser, under any existing contract with the purchaser that includes the sale of any old gas, whether or not named in the first seller's

request, by submitting a written request to the first seller.

(3) Within 30 days after receiving a request from a purchaser for nomination of a price for any gas under a contract that is not named in the first seller's request and that includes the sale of any old gas, the first seller may request the purchaser to nominate a price at which the purchaser is willing to continue buying any old gas under that contract, including old gas for which the purchaser has requested a nomination of price by the first seller, by submitting a written request to the purchaser.

(4) A first seller's request for nomination of a price under paragraph (b)(1) of this section constitutes an offer to release the purchaser from its contract obligation to purchase any gas sold under any existing contract with the first seller, whether or not named in the first seller's request, that includes the sale of any old gas.

(5) (i) The provisions of this paragraph apply when (A) a first seller validly assigns (or otherwise transfers) gas subject to an existing contract to another first seller on or after June 3, 1987 and (B) the assignor or assignee is eligible to request nomination of a price under paragraph (b)(1) of this section.

(ii) If the assignor requests nomination of a price, under paragraph (b)(1) of this section, for old gas sold under any contract between it and the purchaser, the purchaser may request nomination of a price under paragraph (b)(2) of this section for any gas which on June 3, 1987 was subject to an existing contract between the purchaser and the assignor.

(iii) If the assignee requests nomination of a price under paragraph (b)(1) of this section for the assigned gas, the purchaser may request nomination of a price for any gas which on June 3, 1987

was subject to an existing contract between the assignor and the purchaser, but the purchaser may not request nomination of a price for any other gas.

(iv) If the assignee requests nomination of a price under paragraph (b)(1) of this section for old gas other than the assigned gas, the purchaser may not request nomination of a price under paragraph (b)(2) of this section for the assigned gas.

(v) The purchaser must address any requests for nomination of a price authorized by paragraphs (b)(5) (ii) or (iii) of this section to the first seller currently selling it the gas for which nomination of a new price is requested.

(vi) If a first seller receives a request for nomination of a price authorized by paragraph (b)(5) (ii) or (iii) of this section with respect to an existing contract for which it did not make a nomination request under paragraph (b)(1) of this section, the first seller may request under paragraph (b)(3) of this section that the purchaser nominate a price for any old gas sold under that contract, whether or not the contract was named in the nomination request of the assignor or assignee under paragraph (b)(1) of this section.

(c) *No response to request for nomination.* (1) If the purchaser does not nominate a price in writing within 60 days after receiving the first seller's request for nomination of a price, the first seller may offer to sell all or part of the gas named in its request for nomination to a new purchaser. The first seller is authorized, upon 30-days written notice to the existing purchaser, to abandon the sale of the gas if the first seller enters into a written contract for the sale of all or part of the gas to a new purchaser after any necessary compliance with paragraph (g) of this section.

(2) If the first seller does not nominate a price in writing within 60 days after receiving the purchaser's request for nomination of a price, the purchaser may terminate its purchases of all or part of the gas named in its request for nomination at any time upon 60-days written notice to the first seller.

(d) *Purchaser's nomination of highest price.* If the purchaser nominates in writing the highest price to which an existing contract price could escalate with the purchaser's agreement under § 271.402 (c)(7)(ii) of this chapter, and the purchaser does not propose a change in any term of the contract, sales must continue at the nominated price under the terms of the existing contract.

(e) *Purchaser's nomination of lower price; first seller's options.* (1) If the purchaser nominates in writing a price less than the highest price to which the existing contract price could escalate or proposes a change in any other term of the contract, the first seller must accept or reject the nominated price in writing within 30 days after receiving the nomination. If the first seller does not accept the purchaser's nominated price in writing within 30 days, the nominated price is deemed rejected.

(2) If the first seller accepts the nominated price, sales must continue at the agreed-upon price under the other terms of the existing contract, unless such terms are renegotiated by the parties.

(3) If the first seller rejects the nominated price, the first seller must continue sales to the purchaser at the existing price until the sale of the gas is abandoned under this paragraph. At any time after a rejection, the first seller may offer to sell to a new purchaser all or part of the gas for which no price is agreed upon under this paragraph.

(4) A first seller is authorized, upon 30-days written notice to the existing purchaser, to abandon the sale of any gas offered under this paragraph for which the first seller enters into a written contract

with a new purchaser after any necessary compliance with paragraph (g) of this section.

(f) *First seller's nomination of price; purchaser's options.* (1) If the first seller nominates a price in writing in response to the purchaser's request under paragraph (b)(2) of this section, the purchaser must accept or reject the nominated price in writing within 30 days after receiving the nomination. If the purchaser does not accept the first seller's nominated price in writing within 30-days, the nominated price is deemed rejected.

(2) If the purchaser accepts the nominated price, purchases must continue at the agreed-upon price under the other terms of the existing contract, unless such terms are renegotiated by the parties.

(3) If the purchaser rejects the nominated price, the purchaser may at any time terminate its purchases of all or part of the gas named in its request for nomination upon 60-days written notice to the first seller.

(4) The terms of the existing contract apply until the first seller's nominated price or terminates purchases of the gas under this paragraph.

(5) A first seller is authorized to abandon sales of the gas to the purchaser if the purchaser terminates purchases of gas under this section and the first seller enters into a written contract for the sale of the gas to a new purchaser after any necessary compliance with paragraph (g) of this section.

(g) *Existing firm sales customers' right of first refusal*—(1) *General rule.* (i) If the first seller offers to sell gas subject to release due to termination or abandonment under paragraphs (c), (e), or (f) of this section ("offer") to a new purchaser that is not an existing firm sales customer of the existing purchaser, the first seller must present the same offer to all existing firm sales customers, if:

(A) The existing purchaser is not subject to the nondiscriminatory access provisions of § 284.8(b) or § 284.9(b) of this chapter, and;

(B) The offer encompasses the sale of any gas subject to the Commission's jurisdiction under section 1(b) of the Natural Gas Act and is substantially accepted in principle by the new purchaser in an arms-length transaction.

(ii) Any existing firm sales customer has a right of first refusal to purchase the gas under the terms of the offer. The offer must be presented in accordance with the provisions of this paragraph.

(2) *Making the offer.* The offer to a new purchaser that is not an existing firm sales customer must be presented to all such customers of the existing purchaser not later than 10 days after the offer is substantially accepted in principle by the new purchaser. The offer must be tendered by U.S. mail, return receipt requested.

(3) *Acceptance and rejection of offer; no counteroffer.* (i) An existing firm sales customer must accept the offer in writing within 20 days after receiving the offer. The offer is deemed accepted when it is signed and placed in the U.S. mail, return receipt requested. If the offer is not accepted by an existing firm sales customer within 20 days of its receipt, the offer is deemed rejected.

(ii) Any written counteroffer by an existing firm sales customer constitutes a rejection.

(iii) If the first seller receives more than one acceptance from an existing firm sales customer, the first seller may determine which such customer will become the new purchaser.

(4) *Termination of right of first refusal.* If no existing firm sales customer accepts the offer made under this paragraph within 20 days of receiving the offer, the first seller may execute a written contract

with the new purchaser that substantially accepted the offer before it was sent to the existing firm sales customers. Such written contract with a new purchaser is not subject to a right of first refusal.

(5) *Definition.* For purposes of this section, "existing firm sales customer" means a customer with which the existing purchaser has a contract for the sale of gas not subject to prior claim by another customer or another class of service, and at the same priority as any other class of firm service, which is in effect on the date a new purchaser substantially accepts in principle an offer under paragraph (g)(1) of this section.

(h) *Transportation by existing pipeline purchaser.* A purchaser that is an interstate pipeline not subject to the non-discriminatory access provisions of § 284.8(b) or § 284.9(b) of this chapter must transport any gas released due to termination or abandonment under this section, on behalf of any shipper, to any existing customer of the interstate pipeline or to any pipeline to which the interstate pipeline is interconnected, and in accordance with § 284.225 of this chapter, if the purchaser:

(1) Does not submit a timely nomination of a price for gas under paragraph (c)(1) of this section in response to the first seller's request for nomination of a price;

(2) Nominates a price under paragragh (e)(1) of this section that is less than the highest price to which its existing contract price could escalate if it were a new or amended contract;

(3) Terminates purchases of gas under paragraph (c)(2) of this section when the first seller does not submit a timely nomination of a price; or

(4) Terminates purchases of gas under paragraph (f)(3) of this section after rejecting a price for gas nominated by the first seller.

3. 18 C.F.R. 271.402 provides in pertinent part:

§ 271.402 Maximum lawful prices.

* * * * *

(c) *Applicable higher rates.*

* * * * *

(3) In the case of any first sale under any rollover contract to which this subpart applies, the maximum lawful price for the month in which the effective date of such rollover contract occurs is the highest of:

(i) The maximum lawful price applicable to the expiring contract in the month in which the rollover contract becomes effective;

(ii) The price specified in Table II of § 271.101 (a) for interstate rollover gas; or

(iii) The price specified in Table II of § 271.101 (a) for post-1974 gas if the rollover contract becomes effective after July 18, 1986.

* * * * *

(7) The maximum lawful price, per MMBtu, for the first sales of all categories of gas otherwise subject to lower maximum lawful prices under this subpart is the price specified in Table II of § 271.101 (a) for post-1974 gas, if the price is established:

(i) Under a contract or contract amendment executed after July 18, 1986; or

(ii) In accordance with the good faith negotiation procedures of § 270.201 of this chapter.

4. 18 C.F.R. 271.602 provides:

§ 271.602 Maximum lawful price.

(a) *General rule.* The maximum lawful price for a first sale of natural gas under an intrastate roll-

over contract to which section 106(b)(1) of the NGPA applies shall be the highest of:

(1)(i) The maximum lawful price, per MMBtu, paid under the expired contract, in the month in which the rollover contract becomes effective; and

(ii) In any month after the month in which the rollover contract becomes effective, the maximum lawful price, per MMBtu, prescribed under this paragraph for the preceding month adjusted for inflation in accordance with § 271.102;

(2) The alternative maximum lawful price specified in Table 1 of § 271.101(a) for certain intrastate rollover gas; or

(3) The price specified in Table II of § 271.101(a) for post-1974 gas, if the price is established under a contract or contract amendment executed after July 18, 1986.

(b) *Certain State or Indian production or royalty shares.* The maximum lawful price, per MMBtu, for natural gas to which section 106(b)(2) of the NGPA (relating to certain State or Indian natural gas production or royalty interests) applies shall be the price specified for new natural gas (Subpart P of Part 271) in Table I of § 271.101(a).

(c) *Qualified production enhancement gas.* For purposes of paragraph (a)(1)(i) of this section, the maximum lawful price, per MMBtu, paid under the expired contract is deemed to include any amount paid by reason of a maximum lawful price allowed under § 271.704 (relating to qualified production enhancement gas.)

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IN THE
Supreme Court of the United States

OCTOBER TERM, 1990

MOBIL OIL EXPLORATION & PRODUCING SOUTHEAST, INC., *et al.*,
Petitioners,
v.
UNITED DISTRIBUTION COMPANIES, *et al.*,
Respondents.

FEDERAL ENERGY REGULATORY COMMISSION,
Petitioner,
v.
UNITED DISTRIBUTION COMPANIES, *et al.*,
Respondents.

On Writs of Certiorari to the United States Court of Appeals for the Fifth Circuit

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QUESTION PRESENTED

Whether the court of appeals exceeded its reviewing authority or otherwise erred in vacating a nationwide program of the Federal Energy Regulatory Commission designed to increase production of "old" natural gas—*i.e.*, gas in the interstate market from wells drilled prior to 1977—and to eliminate severe distortions caused by the pre-existing ceiling price structure applicable to that gas. Specifically, whether the court of appeals applied an improper standard or otherwise erred:

(1) in setting aside, without regard to the plain statutory language and based solely on the court's reading of the legislative history, the Commission's determination that the Natural Gas Policy Act of 1978 permits the Commission to modify the pre-existing pricing scheme by setting a single, higher ceiling price for old gas;

(2) in setting aside the Commission's determination that the Natural Gas Act authorizes the Commission to specify by rule, rather than case-by-case adjudication, the circumstances in which the Commission will permit abandonment of a facility or service subject to its jurisdiction; and

(3) in requiring the Commission finally to solve, in *this* proceeding, another natural gas policy issue already being addressed in other proceedings—the issue of "take-or-pay" provisions in gas contracts—as a precondition to the Commission's effort to resolve the problem of old gas pricing.

LIST OF PARTIES

A list of parties was provided at Appendix F to the petition for certiorari in No. 89-1452.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

Nos. 89-1452, 89-1453

MOBIL OIL EXPLORATION & PRODUCING SOUTHEAST, INC., *et al.*,
Petitioners,
v.
UNITED DISTRIBUTION COMPANIES, *et al.*,
Respondents.

FEDERAL ENERGY REGULATORY COMMISSION,
Petitioner,
v.
UNITED DISTRIBUTION COMPANILS, *et al.*,
Respondents.

On Writs of Certiorari to the United States Court of Appeals for the Fifth Circuit

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BRIEF OF PETITIONERS IN NO. 89-1452

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-36a), together with the dissenting opinion of Judge Brown (Pet. App. 36a-57a), is reported at 885 F.2d 209 (5th Cir. 1989). Order No. 451 of the Federal Energy Regulatory Commission (J.A. 5-205) is reprinted at 51 Fed. Reg. 22,168 (1986). Order No. 451-A of the Federal Energy Regulatory Commission (J.A. 206-436) is reprinted at 51 Fed. Reg. 46,762 (1986).

JURISDICTION

The judgment of the court of appeals was entered on September 15, 1989. Rehearing was denied on December

15, 1989. Pet. App. 58a. This Court granted certiorari on June 4, 1990. This Court has jurisdiction under 28 U.S.C. § 1254(1).

STATUTES INVOLVED

Section 104(b)(2) of the Natural Gas Policy Act of 1978, which in all relevant respects is identical to Section 106(c) of the same Act, provides:

> **Ceiling prices may be increased if just and reasonable.**—The Commission may, by rule or order, prescribe a maximum lawful ceiling price, applicable to any first sale of any natural gas (or category thereof, as determined by the Commission) otherwise subject to the preceding provisions of this section, if such price is—
>
> (A) higher than the maximum lawful price which would otherwise be applicable under such provisions; and
>
> (B) just and reasonable within the meaning of the Natural Gas Act. 15 U.S.C. § 3314(b)(2); see also 15 U.S.C. § 3316(c).

Section 7(b) of the Natural Gas Act of 1938 provides:

> No natural-gas company shall abandon all or any portion of its facilities subject to the jurisdiction of the Commission, or any service rendered by means of such facilities, without the permission and approval of the Commission first had and obtained, after due hearing, and a finding by the Commission . . . that the present or future public convenience or necessity permit such abandonment. 15 U.S.C. § 717f(b).

STATEMENT

This case concerns the exhaustive efforts of the Federal Energy Regulatory Commission ("Commission" or "FERC") to develop a rational and efficient nationwide program for regulating "old" natural gas—generally, gas in the interstate market from wells drilled before 1977. Following lengthy deliberations over an extensive administrative record, and after a full public hearing, the FERC adopted Orders No. 451 and 451-A (collectively "Order 451"). Order 451 is a carefully crafted set of

regulations designed to relieve serious market distortions and consumer inequities created by the Commission's prior old gas pricing regime. The Commission predicted that those regulations would reduce overall natural gas prices by, among other things, increasing supplies of old gas available to the national gas market and increasing competition among sellers. Such price reductions have in fact occurred during the three years since Order 451 became effective. See *infra* note 3. These beneficial effects notwithstanding, the majority below held that the Commission lacked statutory authority to implement its new regulatory regime.

1. *Regulation of Natural Gas Prior to the NGPA.* The fundamental errors in the court of appeals' decision are best understood in light of the history of natural gas regulation. Prior to 1978, prices for natural gas sold in interstate commerce were regulated exclusively under the Natural Gas Act of 1938 ("NGA"). 15 U.S.C. §§ 717-717w. Beginning in the 1960s, FERC's predecessor, the Federal Power Commission ("FPC") instituted a system of area-wide wellhead ceiling prices for natural gas. The FPC established these ceiling prices according to a system of "vintage" pricing under which a lower ceiling price applied to gas that had already been dedicated to interstate commerce—what was then considered "old" gas—and another, higher ceiling applied to "new" gas. Originally, the vintage pricing system was intended to increase natural gas supplies through higher ceilings on new gas, while moderating price increases to consumers through lower ceilings on existing supplies. See Opinion No. 468, 34 F.P.C. 159, 185-88 (1965); see also J.A. 27; Pet. App. 9a.

From the outset, both the FPC and the courts consistently treated vintage pricing as a temporary expedient which the FPC, exercising its broad ratemaking discretion under the NGA, remained free to modify or eliminate as experience and regulatory needs changed. See Statement of General Policy No. 61-1, 24 F.P.C. 818, 819 (1960). In upholding the FPC's system of area

rates, for example, this Court made clear that the NGA does not prescribe any particular regulatory formula or methodology, including vintage pricing. *Permian Basin Area Rate Cases*, 390 U.S. 747, 775-77, 799-800 (1968). Accordingly, the FPC received judicial approval when it implemented its 1972 conclusion that vintaging was "an anachronism which we should now move to eliminate." Opinion No. 639, 48 FPC 1299, 1309 (1972), *aff'd sub nom. Shell Oil Co.* v. *FPC*, 491 F.2d 82, 88 (5th Cir. 1974); see Opinion No. 699-H, 52 FPC 1604, 1631-32 (1974), *aff'd sub nom. Shell Oil Co.* v. *FPC*, 520 F.2d 1061 (5th Cir. 1975), *cert. denied*, 426 U.S. 941 (1976). The court of appeals also approved when the FPC, having reinstated vintage pricing in 1976, consolidated a number of the most outdated vintages into a single vintage category for all gas already under production before 1973. Opinion No. 749, 54 FPC 3090 (1975), *aff'd sub nom. Tenneco Oil Co.* v. *FERC*, 571 F.2d 834 (5th Cir.), *cert. dismissed*, 439 U.S. 801 (1978). Despite that consolidation, the FPC's vintage pricing structure still contained 16 different categories of old gas—each with its own ceiling price—when the FERC inherited the FPC's regulatory authority in 1977. J.A. 223.

2. *The NGPA and its Aftermath.* The vintage pricing structure contributed to the acute gas shortages that plagued the interstate market during the 1970s. Ceiling prices for many categories of gas were artificially low. Those prices, in turn, generated a steady increase in demand for natural gas and a concomitant decrease in the supply available to the interstate market. This reduction in supply was exacerbated by intense competition from an unregulated intrastate gas market and by the ever-increasing cost and risk of exploring for and developing new gas supplies. Moreover, periodic rate reviews by the FPC and the FERC were cumbersome and costly, and failed to keep pace with the fast-changing market.[1]

[1] See generally S. Williams, *The Natural Gas Revolution of 1985* 1 (1987); Pierce, *Reconstituting the Natural Gas Industry From Wellhead To Burnertip*, 9 Energy L.J. 1, 8-11 (1988).

To forestall an imminent natural gas supply crisis, Congress in 1978 enacted the Natural Gas Policy Act ("NGPA"). The NGPA was designed to eliminate gas shortages in the interstate market and to streamline and rationalize the regulatory process. *Public Service Comm'n* v. *Mid-Louisiana Gas Co.*, 463 U.S. 319, 330-31 (1983). Abandoning the assumption of monopoly power on which the prior regulatory regime had been built, Congress determined that the producing segment of the natural gas industry was workably competitive. *Transcontinental Gas Pipe Line Corp.* v. *State Oil & Gas Bd.*, 474 U.S. 409, 420-21 (1986). Accordingly, Congress immediately provided higher price ceilings for "new" natural gas and enacted a scheme of phased deregulation for most of that gas. 92 Stat. 3350 (codified at 15 U.S.C. §§ 3301 *et seq.*).

Congress, however, did not itself undertake to restructure the pre-existing ceiling prices for old gas. Instead, it modified the existing structure in two respects. First, in NGPA Sections 104 and 106, Congress adopted initial ceiling prices that had as their starting point the most recent ceilings established by the Commission pursuant to the NGA's just and reasonable standard; these ceilings were to be adjusted automatically for inflation. 15 U.S.C. §§ 3314(b)(1), 3316(a). Second, Congress "recognize[d] that the ceiling[s] may be too *low* and authorize[d] the Commission to raise" them pursuant to certain statutory criteria. *Mid-Louisiana Gas Co., supra*, 463 U.S. at 333. Specifically, Sections 104(b)(2) and 106(c) expressly authorized the Commission, "by rule or order," to change the ceiling prices for "any natural gas . . . or category thereof . . . otherwise subject to [Sections 104 and 106]," conditioned only by two requirements: (1) that the new ceiling be higher than the ceiling set by the NGPA, and (2) that it be "just and reasonable" within the meaning of the NGA. 15 U.S.C. §§ 3314(b)(1), 3316(a). Congress enacted this provision against the background of the FERC's prior reliance upon the just and reasonable standard of the NGA, not only to increase ceiling prices, but also to modify and, at times, eliminate the vintage

pricing structure applicable to old gas. See, *e.g.*, Opinion No. 639, *supra;* Opinion No. 699-H, *supra;* Opinion No. 749, *supra.*

3. *The Secretary of Energy's Proposal.* By 1985, as a result of the price incentives offered by the NGPA, the gas shortages of the 1970s had been overtaken by substantial increases in supply. This caused a substantial reduction in prices at the wellhead. Yet market rigidities created by the existing regulatory structure prevented these reductions from being passed on to consumers in the form of substantially lower "burnertip" prices.

Accordingly, in a 1985 notice of proposed rulemaking issued under Section 403 of the Department of Energy Organization Act (42 U.S.C. § 7173(a)), the Secretary of Energy urged the Commission to use its statutory authority to reassess and, if necessary, to modify the pricing of old gas. 50 Fed. Reg 48,540 (1985). The Secretary observed that artificially low old gas prices under the vintage pricing system were causing producers to forsake old wells in favor of investment in new wells, which, although more expensive, were more profitable because of higher price ceilings. 50 Fed. Reg. at 48,543. In the Secretary's view, this distortion of producer incentives hurt consumers because it forced them to pay more for natural gas, on average, than they otherwise would. 50 Fed. Reg. at 48,543-44. The Secretary also noted that vintage pricing of old gas had created what he characterized as a "gargantuan inequity" in the treatment of consumers in various parts of the country: It forced consumers whose suppliers did not have significant inventories of low-priced old gas to pay substantially more than other gas customers. 50 Fed. Reg. 48,541.

In sum, the Secretary argued that vintage pricing of old gas was an "unnecessary anachronism" that can be understood only as an "accident of an historic ratemaking process that was ultimately unsuccessful in accomplishing its stated objectives of ensuring an adequate supply of natural gas for consumers at reasonable prices while providing a reasonable return and incentive for producers." 50 Fed. Reg. at 48,542. The Secretary therefore urged the Commission to use its authority under Sections 104(b)(2) and 106(c) to eliminate vintage pricing of old gas. 50 Fed. Reg. at 48,545.

4. *The Commission's Orders.* The Commission analyzed approximately 113 sets of comments and held two days of public hearings on the Secretary's proposal. At the conclusion of those hearings, the Commission issued Order 451, which was later clarified in Order 451-A.

In its orders, the Commission found that vintage pricing of old gas was inequitable because it required consumers in some areas of the country to pay substantially more than similarly situated consumers in other areas. J.A. 25, 227.[2] Moreover, because of the pipelines' ability to average or "roll in" prices for higher-cost gas supplies with prices for lower-cost supplies, consumers were not realizing the benefits of artificially low prices for old gas. J.A. 25, 229-30. The Commission also found that artificially low prices were skewing development and recovery efforts away from old gas even though that gas is cheaper to produce than new gas. This, the Commission found, was causing producers to forsake old gas wells prematurely. J.A. 24, 227-28.

The Commission further found that collapsing the vintage pricing structure of old gas would benefit consumers. The Commission estimated that, during the following decade, that action would lead to the production of 11 Tcf of additional old gas, resulting in savings to consumers of approximately $25 billion. J.A. 16, 99, 295-60; 50 Fed. Reg. at 48,540. The Commission also found that collapsing the vintage pricing structure for old gas would reduce overall prices for the vast majority of consumers, even though it would temporarily increase prices in a

[2] The Commission noted, for example, that consumers in the Washington, D.C. area were paying their local distribution companies $8.05/Mcf, while consumers in Kansas, whose suppliers had access to substantial old gas, were paying $4.49/Mcf. See J.A. 25; see also Pet. App. 39a-40a n. 2 (Brown, J., dissenting).

few regions where gas prices were artificially low. See J.A. 119-37. In fact, average prices for natural gas *have* substantially decreased since Order 451 went into effect, just as the FERC predicted.[8]

Order 451 has three principal and interrelated components:

a. *Ceiling Prices For Old Gas.* First, acting pursuant to its express authority under Sections 104(b)(2) and 106(c) of the NGPA, the FERC established a single ceiling price that potentially applied to all vintages of old gas. In so doing, FERC did not abolish the existing price ceilings under Sections 104 and 106, because a producer was not permitted to collect the new maximum price without first meeting several significant conditions. See *infra* p. 10. For that reason, the FERC referred to the new ceiling as an "alternative ceiling price." *E.g.*, J.A. 9. Moreover, the FERC did not eliminate the overall vintage pricing structure established in the NGPA; instead, it kept the alternative ceiling price for old gas below the ceilings applicable to the other categories of gas (*e.g.*, "new" gas). See, *e.g.*, J.A. 41-42, 222. The Commission merely consolidated all of the multiple vintage categories—or "subvintages"—of old gas into a single vintage category subject to a single, already-existing ceiling price. It thereby eliminated vintage pricing *only* within the category of gas covered by Sections 104 and 106, and *only* to the extent a producer could satisfy the

[8] Average residential retail prices declined from an annual average of $5.83 per Mcf in 1986 to an annual average of $5.63 in 1989, a reduction of 3 percent before adjusting for inflation, and approximately 15 percent after adjusting for inflation. Wellhead prices (*i.e.*, prices charged by producers) have declined from an annual average of $1.94 per Mcf in 1986 to an annual average of $1.71 in 1989, a reduction of 12 percent before adjusting for inflation, and approximately 25 percent after adjusting for inflation. See U.S. Dept. of Energy, Energy Information Admin., *Natural Gas Monthly* 33 (March 1990) (Table 4) ("EIA Report"); Joint Economic Comm., *Economic Indicators* 23 (May 1990) (consumer price index increased from 109.6 in 1986 to 124.0 in 1989).

conditions for charging a rate up to the new, alternative maximum price.

Several times the Commission expressly addressed the scope of its authority under Sections 104(b)(2) and 106(c) to set a single ceiling price for all old gas. The Commission concluded that its action was authorized by Congress because "the express and unambiguous terms" of those provisions "specifically authorize the Commission to raise old gas prices, subject only to the requirement that the Commission find that the higher rates are just and reasonable within the meaning of the NGA." J.A. 50; see also J.A. 18, 31, 216. The Commission found no support for, and therefore rejected, suggestions that certain isolated statements during the Senate and House debates on the NGPA indicated a congressional intent to preclude the FERC from eliminating vintage pricing of old gas. J.A. 50, 219-21. It also rejected arguments that it was in effect "deregulating" old gas: It explained that it was retaining both (a) a ceiling price applicable to that gas and (b) its authority to change that ceiling price—or even reinstate vintage pricing—if it determined that the ceiling price was no longer just and reasonable. See, *e.g.*, J.A. 171, 219-22.

The maximum price was set at $2.57 per million Btus ("MMBtu"), the existing ceiling price for the most recent (*i.e.*, the post-1974) old gas vintage. The Commission found this to be a just and reasonable price for all gas subject to Sections 104 and 106: It concluded, based upon two cost studies, that this price generally approximated the replacement cost of gas. See J.A. 76, 233-34. In contrast to historic costs, replacement cost measures the current cost of finding new gas fields, drilling new wells and producing new gas. J.A. 75, 237-38. The Commission found that replacement cost is an appropriate benchmark for setting a just and reasonable ceiling price for old gas because it best represents the marginal opportunity cost of using existing gas supplies. J.A. 83, 248. The Commission also noted that the courts had previously affirmed the Commission's reliance upon replacement cost methodology

in establishing just and reasonable rates. J.A. 74-75 (citing *Shell Oil Co.* v. *FPC*, 520 F.2d 1061 (5th Cir. 1975), *cert. denied*, 426 U.S. 941 (1976)). The Commission, however, permitted producers to collect a price above the old ceiling *only* if the purchaser agreed, after the issuance of Order 451, to pay a higher price, either under its existing contract or in a new contract. J.A. 141-142.

b. *The GFN Procedure and Abandonment.* As its second principal element, Order 451 requires producers to enter into negotiations with their pipeline purchasers before they can collect a higher price, even when the parties' existing contract would permit the producer, without further negotiations, to collect a price higher than the prior ceiling. J.A. 141, 295. If the parties are unable voluntarily to negotiate a new or amended contract price, Order 451 specifies a structured "good faith negotiation" ("GFN") procedure with which producers must comply before charging a price in excess of the prior ceiling, and which they may invoke *only* if they have preexisting contractual authority for charging a higher price. *Id.* To provide pipelines with additional bargaining power, Order 451 grants them the right, in response to a producer's invocation of the GFN procedure, to require the producer to renegotiate the prices previously agreed upon for any other gas (including new, deregulated and "high-cost" gas) in any contract that covers at least some old gas (*i.e.*, a "multivintage" contract). J.A. 151-52. The Commission anticipated that this procedure would act as a stimulus for producers and pipelines voluntarily to restructure their contractual relationships so that the prices paid for all natural gas would be more market responsive. J.A. 319-21.

The Commission also held that, in cases where the parties are unable to agree on a new price for sales of old or new gas after compliance with the GFN procedure, either the producer or the pipeline may abandon its existing obligations, thereby making the gas at issue available to the market. The Commission found that abandonment in these circumstances would further the "public

convenience and necessity," as required by Section 7(b) of the NGA. J.A. 147. The Commission based this conclusion upon the substantive standard it had previously announced in *Felmont Oil Corp. and Essex Offshore, Inc.*, 33 FERC ¶ 61,333 at 61,657 (1985), *rev'd and remanded on other grounds sub nom. Consolidated Edison Co.* v. *FERC*, 823 F.2d 630 (D.C. Cir. 1987). Under that standard, the Commission's abandonment decision is based upon the "overall needs of the market" rather than on the "comparative needs" of the affected customers. J.A. 22, 147.

The Commission also found that abandonment under the GFN procedure satisfies all of the *procedural* requirements of Section 7(b). The Commission concluded that the "due hearing" requirement in Section 7(b) "does not require that the Commission hold individual case-by-case hearings" where an abandonment satisfies the FERC's pre-established criteria. J.A. 147. The Commission also rejected claims that granting abandonment under the GFN process is contrary to *United Gas Pipe Line Co.* v. *McCombs*, 442 U.S. 529 (1979). J.A. 306-07. In short, the Commission held that Section 7(b) permits it to authorize abandonments by administrative rule, without case-by-case adjudication. J.A. 307-09.

c. *Take Or Pay.* Finally, the Commission rejected suggestions that it should undertake to resolve completely the issue of take-or-pay provisions in certain natural gas contracts at the same time and in the same proceeding in which it addressed old gas pricing.[4] The Commission explained that it was already addressing the take-or-pay issue in its Order 436 proceedings. J.A. 292-95. The Commission also explained that, by permitting increased ceiling prices for old gas, Order 451 would allow pipe-

[4] Since the 1950s, many pipelines entered into long-term contracts requiring them to take a specified volume of gas or, in the event the gas was not taken, to pay for the specified volume. See, *e.g.*, Pierce, *supra*, at 15. Contracts which include such provisions are commonly referred to as "take-or-pay" contracts.

lines to offer producers higher prices for old gas in exchange for renegotiation of take-or-pay obligations, thereby facilitating settlement of take-or-pay disputes. J.A. 120-21. The Commission further found that the "release" to the market of old gas abandoned under Order 451 would decrease the market price of new gas and thereby reduce the aggregate value of pipelines' take-or-pay obligations. J.A. 122. In short, the Commission rejected the suggestion that the take-or-pay issue was so intertwined with vintage pricing of old gas as to require the Commission to take any further steps to resolve both issues in this proceeding. J.A. 292-93.

5. *The Decision Below.* On September 15, 1989, a divided panel of the court of appeals vacated the Commission's orders. No member of the panel disputed the findings of the FERC concerning the likely benefits of collapsing the vintage pricing structure of old gas. See, *e.g.*, Pet. App. 23a. Indeed, the majority agreed that the end result of the Commission's action was "arguably meritorious." Pet. App. 25a. The majority nonetheless held that the Commission had exceeded its statutory authority in three respects relevant here.

First, the majority concluded that Congress did not intend to give the Commission authority in Sections 104 (b)(2) and 106(c) to set a single ceiling price for all old gas. Pet. App. 23a-24a. According to the majority, vintage pricing of old gas is too "significant [a] feature of the NGPA" to be "jettison[ed]" by the Commission. Pet. App. 25a. The court of appeals also expressed the view that the ceiling price set by the Commission was impermissible because it was higher than the spot market price when Order 451 was issued and therefore, in the majority's view, amounted to "de facto deregulation." Pet. App. 14a n.15, 19a. Eschewing the plain statutory language, and deferring not at all to the Commission's interpretation of that language, the majority relied upon its own perception that the NGPA reflected a "congressional compromise" forever to preserve the existing pricing structure for old gas. See Pet. App. 19a-25a.

Second, the majority rejected the abandonment procedure adopted in Order 451. Without deferring to the Commission's interpretation of Section 7(b), the majority held that the Commission lacks authority under that statute to "provid[e] for an across the board, preauthorized abandonment provision" (Pet. App. 29a), notwithstanding the Commission's determination that abandonments pursuant to Order 451 satisfied the "public convenience and necessity" requirement of the NGA. Furthermore, relying upon *United Gas Pipe Line Co.* v. *McCombs*, 442 U.S. 529 (1979), the majority held that Order 451 violates Section 7(b) because, in its view, that gives the producer too much control over the abandonment decision. Pet. App. 28a-29a.

Third, the majority castigated the Commission for failing to resolve the take-or-pay issue in the Order 451 proceeding. Pet. App. 29a. Although it implicitly recognized that the Commission was already addressing the take-or-pay issue on remand from the D.C. Circuit's decision in *Associated Gas Distributors* v. *FERC*, 824 F.2d 981 (D.C. Cir. 1987), *cert. denied*, 485 U.S. 1006 (1988), the majority contended that the Commission's decision not to resolve that issue in Order 451 was a "regrettable and unwarranted" refusal to deal with a major problem. Pet. App. 32a.

Judge Brown strongly dissented from each of these holdings. He observed that the fundamental flaw in the majority's entire analysis was its decision to "[s]ubstitute[] its own judgment for that of the Commission on what Congress has ordained the Commission may do about the grave problems of the natural gas business." Pet. App. 37a.

SUMMARY OF ARGUMENT

The regulatory regime created by Order 451 is a carefully considered, balanced and lawful response to the severe distortions caused by the pre-existing ceiling price structure applicable to old gas. The Commission reasonably concluded that those distortions were inhibiting the

production of natural gas and, at the same time, were forcing consumers to pay higher prices than they otherwise would pay.

In vacating Order 451, the majority repeatedly violated two well-settled principles: First, a court may not rely upon its own view of the broad "purposes" underlying a statute to override the statute's plain meaning (*e.g.*, *Rodriguez* v. *United States*, 480 U.S. 522, 526 (1987)) or to overturn the administering agency's reasonable construction of the statutory language (*e.g.*, *K Mart Corp.* v. *Cartier Inc.*, 486 U.S. 281, 291-92 (1988)). Second, an administrative agency is entitled to judicial deference, not only in interpreting its own organic statutes (*e.g.*, *Chevron U.S.A.* v. *NRDC*, 467 U.S. 837 (1984)), but also in determining how best to carry out its statutory mandate (*e.g.*, *Vermont Yankee Nuclear Power Corp.* v. *NRDC*, 435 U.S. 519 (1978); *Heckler* v. *Chaney*, 470 U.S. 821 (1985)). The majority's refusal to adhere to these fundamental principles pervades its analysis of the three issues presented in this case.

I.

The lawfulness of the Commission's decision to adopt a single ceiling price for all old gas can and should be decided on the sole basis of the NGPA's plain language. The Commission's decision fully complies with the only two requirements imposed by the language of Sections 104(b)(2) and 106(c): (1) the Commission's ceiling price for old gas is higher than the corresponding ceiling set by the NGPA for that category of gas; and (2) the Commission properly found that the new ceiling is "just and reasonable" within the meaning of the NGA. The Commission's compliance with all applicable statutory requirements is the complete answer to the majority's view that the pricing aspects of Order 451 are somehow defective because they allegedly give rise to "de facto deregulation."

The plain language of Sections 104(b)(2) and 106(c) also refutes the majority's conclusion that the Commission lacks the authority to set a single ceiling price for

all old gas and to collapse the vintage pricing structure within that category. By their terms, those provisions authorize the Commission, "by rule or order," to set "*a* maximum lawful ceiling price" for "any category" of old gas. 15 U.S.C. §§ 3314(b)(2), 3316(c) (emphasis added).

The *only* constraint on the Commission's authority to increase the ceiling price for a category of old gas is the requirement that the resulting ceiling be "just and reasonable." *Id.* But that "limitation," which in fact is a broad delegation of authority, does not foreclose setting a single ceiling price for all old gas. The statute authorizes the Commission, in its discretion, to adopt any ratemaking methodology—including one based upon replacement costs—that yields a "reasonable" rate. Thus, although Congress could easily have limited the Commission's discretion to modify the existing pricing structure for old gas, it did not do so. Instead, it preserved the Commission's preexisting authority under the "just and reasonable" standard of the NGA to modify or even abolish vintage pricing, as the Commission had done with judicial approval in the past. See *supra* pp. 3-4. And if there were any conceivable doubt on the issue, the court of appeals was obligated to defer to the Commission's interpretation of the statute, something the majority failed to do.

II.

The majority's analysis of the abandonment issue is similarly flawed. The substantive abandonment standard applied by the Commission—the "overall needs of the market" standard—is not at issue in this case. Instead, the sole issue is whether the Commission's procedures are adequate under Section 7(b). The Commission, however, fully complied with all three procedural requirements imposed by Section 7(b): It approved the abandonment; it found that abandonment under Order 451's GFN procedure would be consistent with the "present or future public convenience or necessity"; and it granted its approval only after a rulemaking "hearing." See 15 U.S.C.

§ 717f(b). The plain statutory language thus disposes of the abandonment issue.

There is no merit to the majority's view that Section 7(b) nonetheless requires the Commission to conduct a case-by-case inquiry into *each* abandonment before giving final approval. By its terms, Section 7(b) does not require any specific kind of "hearing." Indeed, it grants the Commission discretion to determine what kind of inquiry is "due." Here the Commission reasonably concluded that a case-by-case inquiry is unnecessary in light of the substantive standard it was applying. Moreover, the majority's attempt to engraft a case-by-case inquiry requirement onto Section 7(b) is precluded by several decisions of this Court. *E.g., FPC* v. *Texaco Inc.*, 377 U.S. 33, 39-41 (1964). The majority also misinterpreted this Court's decision in *United Gas Line Co.* v. *McCombs*, 442 U.S. 529 (1979), in denying the Commission the authority to pre-grant abandonment whenever, in the opinion of a reviewing court, the Commission's procedures give too much "control" to one side or the other.

III.

The majority's requirement that the Commission fully resolve the take-or-pay issue as a prerequisite to resolving the old gas pricing issues resolved in Order 451 improperly interferes with the Commission's discretion to manage its priorities as it deems appropriate. *E.g., Vermont Yankee*, 435 U.S. at 543; *Heckler*, 470 U.S. at 831-32. The court's interference with the Commission's Order 451 program is especially inappropriate because FERC is *already* attempting fully to resolve the take-or-pay issue in other proceedings, and because FERC reasonably concluded in this case that Order 451 would do more to improve the take-or-pay situation than to worsen it. But even if the majority's contrary assessment were correct, the mere fact that a resolution of one issue "exacerbates" another regulatory issue provides no basis for a court to *require* the agency to address both issues in the same proceeding.

ARGUMENT

I. THE COMMISSION HAS AMPLE STATUTORY AUTHORITY TO INCREASE OLD GAS CEILING PRICES AS IT DID IN ORDER 451.

The heart of Order 451 is its modification of ceiling prices for old gas pursuant to Sections 104(b)(2) and 106(c) of the NGPA. By their terms, those provisions authorize the Commission to establish a ceiling price other than that adopted by the NGPA, provided the ceiling satisfies two requirements: (1) it must be higher than the ceiling set by the NGPA for that category of gas; and (2) it must be "just and reasonable" within the meaning of the NGA. See *Public Service Comm'n* v. *Mid-Louisiana Gas Co., supra*, 463 U.S. at 333-34. The Commission fully complied with both requirements in adopting the ceiling price imposed by Order 451: The ceiling price set by the Commission is higher than (or equal to) the NGPA ceiling prices applicable to all categories of old gas affected by Order 451, and the Commission reasonably found that this price was just and reasonable based upon settled ratemaking principles. Under the plain statutory language, that ends the inquiry.

The court of appeals nonetheless concluded that the Commission lacks authority under Sections 104 and 106 to "abrogat[e] the vintage pricing structure" (Pet. App. 25a) by setting a single ceiling price for all vintages of old gas. The majority also suggested that the ceiling price chosen by the FERC is inconsistent with congressional intent because it is above the spot market price that existed when Order 451 was promulgated and therefore, in the majority's view, "allow[s] for de facto [de]regulation of old gas." Pet. App. 19a. There is no merit to either of these specific complaints. Nor is there any merit to the majority's view that the Commission's action is contrary to a speculative "congressional intent," which the majority derived from its interpretation of legislative history but did not—and could not—find anywhere in the statutory text. Pet. App. 19a-22a.

A. The Plain Language Of Sections 104 and 106 Gives The Commission Authority To Set A Single Ceiling Price For All Vintages Of Old Gas.

The short answer to the court of appeals' analysis of the vintage pricing question is that the Commission has express authority under Sections 104 and 106 to increase the ceiling price for any "category"—including any vintage—of old gas, provided *only* that the resulting ceiling is "just and reasonable." Because there is nothing in the "just and reasonable" standard that requires different ceilings for different vintages of old gas, the Commission's authority to set a single ceiling price for all old gas follows from the plain statutory language. Under this Court's decisions, that is the end of the matter. *E.g.*, *K Mart*, 486 U.S. at 291-92. And if there were any doubt about the issue, the Commission's interpretation of those sections must be upheld because it is, at a minimum, a reasonable interpretation of the statutory language. *Chevron*, 467 U.S. at 844.

1. Sections 104(b)(2) and 106(c) unambiguously authorize the Commission to increase the ceiling price for "*any natural gas* [governed by Sections 104 and 106] (*or category thereof, as determined by the Commission*)." 15 U.S.C. § 3314(b)(2), § 3316(c) (emphasis added). Those provisions, moreover, give the Commission the "sweeping" authority (see Pet. App. 47a (Brown, J., dissenting)) to raise ceiling prices 'by rule or order." 15 U.S.C. § 3314(b)(2), § 3316(c). Because these provisions grant the Commission authority to increase ceiling prices for an entire "category" of gas, and to do so through rulemaking (*i.e.*, "by rule") as well as through case-by-case adjudication (*i.e.*, "by order"), this authority is obviously not limited to case-by-case "special relief," as the court of appeals suggested. See Pet. App. 24a n.24.[5]

[5] Special relief is expressly available under Section 502(c) of the NGPA. See 15 U.S.C. § 3412(c). The court of appeals' suggestion that Sections 104(b)(2) and 106(c) are limited to special relief would render Section 502(c) redundant, contrary to settled prin-

And, because each old gas vintage constitutes a "category" of old gas, the Commission is authorized to increase the ceiling price for an entire vintage of old gas. The only questions, therefore, are whether anything in Sections 104(b)(2) and 106(c) prevents the Commission from (a) increasing the ceiling price for multiple old gas vintages simultaneously, and (b) setting the ceiling price applicable to each vintage at the same level.

The Commission's authority to increase the ceiling prices for multiple old gas vintages simultaneously cannot be seriously disputed. The authority to increase the ceiling price for "*any* . . . category" of old gas necessarily encompasses the authority to increase the ceiling price for multiple categories or, indeed, for *all* categories. See, *e.g.*, *United States* v. *Lee Stoller Enters., Inc.*, 652 F.2d 1313, 1317 (7th Cir.), *cert. denied*, 454 U.S. 1082 (1981) ("The word 'any' . . . has a comprehensive meaning of 'all or every' ").[6]

The Commission's authority to set the ceiling price applicable to each vintage at the same level is also clear from the statutory language. Sections 104(b)(2) and 106(c) permit the Commission to "prescribe *a* maximum lawful ceiling price, applicable to any . . . category" of gas. 15 U.S.C. §§ 3314(b)(2), 3316(c) (emphasis added). Inasmuch as "any" encompasses "all," this language gives the Commission discretion to set a single ceiling price for any combination of categories.[7] Sections

ciples of statutory interpretation. See, *e.g.*, *Mountain States Tel. & Tel. Co.* v. *Pueblo of Santa Ana*, 472 U.S. 237, 249 (1985); *United States* v. *Menasche*, 348 U.S. 528, 538-39 (1955).

[6] See also, *e.g.*, *County of Loudoun* v. *Parker*, 136 S.E. 2d 805, 809 (Va. 1964) (absent limitation, "any" in statute encompasses "all") (citing Black's Law Dictionary, 3d ed. and Webster's 3d New International Dictionary).

[7] Moreover, the word "category" is broader than "vintage." It can mean, for example, the broad "category" of all old gas or all new gas. *Pennzoil Co.* v. *FERC*, 645 F.2d 360, 372 (5th Cir. 1981), *cert. denied*, 454 U.S. 1142 (1982); see also Order No. 72, Final Regulations Implementing Section 109 of the National Gas

104(b)(2) and 106(c) therefore give the Commission express authority to set "*a* maximum lawful ceiling price" for all old gas. The statutory language could hardly be more expansive or more plain.

2. The Commission's decision to collapse vintage pricing of old gas is also fully consistent with the "just and reasonable" requirement of Sections 104 and 106. Certainly, nothing in that language suggests any obligation on the Commission's part to retain multiple ceiling prices for different old gas vintages. To the contrary, the history of vintage pricing under the NGA's "just and reasonable" standard demonstrates that Congress's inclusion of that standard in the NGPA is less a limitation than it is a broad grant of ratemaking authority.

Vintage pricing—*i.e.*, a system in which ceiling prices vary inversely with the length of time a gas well has been in production—is not an inherently necessary feature of natural gas regulation. Indeed, as previously explained (*supra* pp. 3-4), the Commission had declined to use it on several occasions prior to the NGPA. It was largely the product of "original" or "historic" cost ratemaking applied on a regional or nationwide basis. See J.A. 74; Pierce, *supra* note 1, at 9. The original policy justification for vintage pricing was the belief that, by preserving lower prices for gas from "older" wells, this system would moderate the impact on consumers of higher prices attributable to increased costs for newer production by creating an "average" price below the cost of the new gas. At the same time, it was thought that this system would provide adequate price incentives for the discovery and production of new gas. See *supra* p. 3.

In Order 451, however, the Commission found that substantial changes in natural gas markets had rendered the existing vintage pricing system unjust and unreasonable as applied to old gas. J.A. 61, 223. Far from insulating consumers from higher prices, the Commission found that the vintage pricing structure was depressing the overall supply of natural gas and thereby increasing its average price. See *supra* p. 7. Neither the majority below nor the respondents have challenged that finding, the correctness of which is confirmed by the substantial decline in average gas prices since Order 451 collapsed the vintage pricing structure. See *supra* note 3. The Commission also determined that, in order to elicit the maximum supply of old gas, the ceiling price for that gas should be determined on the basis of replacement costs. J.A. 78-83, 250. Replacement cost is the current cost of finding, developing and producing natural gas. J.A. 75, 248-50. Because the replacement cost of all natural gas is the same regardless of the date it was placed in production, the Commission's methodology necessarily collapsed the vintage pricing structure within the affected category of gas, *i.e.*, old gas. Indeed, the Commission's earlier decisions to eliminate vintage pricing among various categories of old gas had employed a replacement cost-based methodology to the same effect. See *supra* p. 4.

Flowing as it does from the Commission's use of a replacement cost-based methodology, the Commission's decision to collapse vintage pricing of old gas is unquestionably within its authority under the just and reasonable standard. First, this Court has held that the just and reasonable standard does not bind the Commission "to the use of any single formula or combination of formulae in determining rates." *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944); *FPC* v. *Natural Gas Pipeline Co.*, 315 U.S. 575, 586 (1942); *Permian, supra*, 390 U.S. at 775-77, 790, 799-800; *Mobil Oil Co.* v. *FPC*, 417 U.S. 283, 308 (1974). Thus, the Commission is entitled to the widest discretion in choosing the methodology used in setting ceiling prices, and this Court has consistently upheld the Commission when it has shifted from one methodology in favor of another one. *Hope*, 320 U.S. at 602; *Permian*, 390 U.S. at 799-800; see also

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Policy Act, FERC Stats. & Regs. (CCH) ¶ 30,135 at 30,964 (1980) (using "category" to refer to all new and deregulated gas).

Tenneco Oil Co. v. *FERC*, 571 F.2d 834, 840 (5th Cir.), *cert. dismissed*, 439 U.S. 801 (1978) ("Insofar as theories of regulation are concerned, the choice between actual cost and replacement cost is for the Commission to make . . .").

Second, replacement cost is a well-established basis for establishing just and reasonable rates. The Commission employed a replacement cost-based method in several proceedings prior to the enactment of the NGPA, and was affirmed on appeal each time. *E.g., Shell Oil Co.* v. *FPC*, 520 F.2d 1061, 1082-83 (5th Cir. 1975), *cert. denied*, 426 U.S. 941 (1976); *American Public Gas Ass'n* v. *FPC*, 567 F.2d 1016, 1059 (D.C. Cir. 1977), *cert. denied*, 435 U.S. 907 (1978); *Tenneco Oil, supra*. This Court, moreover, has previously recognized the validity of ratemaking methodologies based upon current or projected costs (like the replacement cost methodology used by the Commission here) rather than historic costs. *E.g., Permian*, 390 U.S. at 792. Thus, the "just and reasonable" standard of the NGA plainly permits the Commission to rely upon replacement costs to set a single ceiling price applicable to all old gas vintages.[8]

In light of the Commission's well-established discretion to depart from historic cost ratemaking under the NGA's just and reasonable standard, Congress's decision to incorporate that standard into the NGPA precludes any contention that Congress intended to limit the Commission's authority to modify or eliminate vintage pricing of old gas. See, *e.g., Morissette* v. *United States*, 342 U.S. 246, 263 (1952) (terms of art appearing in statute should be given their commonly understood meaning). By expressly granting the Commission the same well-defined powers in the NGPA, Congress ensured that the Commission would retain the ability, *inter alia*, to col-

[8] As explained later (*infra* p. 26), the particular modification of the vintage pricing structure implemented in Order 451 is well within the Commission's discretion. The overall "end result" of Order 451 plainly cannot be considered unjust and unreasonable because the Commission reasonably (and correctly) found that its order would increase supply and reduce overall prices.

lapse the old gas vintage pricing structure if the Commission determined, as it did in Order 451, that new market conditions warranted such a change.[9]

3. This, then, is the archetypal case in which "the plain language of the statute itself . . . is sufficient to resolve the question presented." *United States* v. *Weber Aircraft Corp.*, 465 U.S. 792, 798 (1984). But even if there were any doubt about the Commission's authority under Sections 104(b)(2) and 106(c) to set a single ceiling price for all vintages of old gas, this Court should nonetheless uphold the Commission's careful and reasoned interpretation. Under this Court's prior decisions, the Commission's interpretation of its own organic statute is controlling as long as it is "not in conflict with" or not "manifestly contrary to" the statutory language. *E.g., Chevron*, 467 U.S. at 844; *K Mart Corp.* v. *Cartier, Inc.*, 486 U.S. 281, 292 (1988); *Atkins* v. *Rivera*, 477 U.S. 154, 162 (1986); *Mobil Oil Co.* v. *FPC*, 417 U.S. 283, 315-17 (1974); *Permian*, 390 U.S. at 770. The Commission's interpretation of Sections 104(b)(2) and 106(c) plainly satisfies that standard.

B. The Ceiling Price Chosen By FERC Is Not Impermissible Solely By Virtue Of Its Being Higher Than The Then-Existing Spot Market Price.

Aside from its objection to the collapsing of the old gas vintage pricing structure, the majority below also objected to the ceiling price chosen by the Commission because that price was higher than the then-existing spot market price. As explained previously (*supra* pp. 9-10), that price was simply the inflation-adjusted ceiling price,

[9] The *only* respect in which the NGPA altered the Commission's authority over old gas pricing was its requirement that the Commission only increase, but not reduce, the inflation-adjusted ceiling prices established in the NGPA. That modification itself suggests that Congress did not intend to bind the Commission to historic cost ratemaking. Historic costs are fixed, by definition. Accordingly, unless the Commission used a methodology other than historic costs, it could not arrive at a new ceiling price in excess of the inflation-adjusted NGPA ceiling.

based in large part on replacement costs, that the Commission had previously set for the post-1974 old gas vintage, and which Congress had incorporated into the NGPA for that vintage.[10] The majority nonetheless opined that, because the Commission's ceiling price for old gas was somewhat higher than the then-prevailing spot market price, this ceiling price amounted to "de facto deregulation." Pet. App. 19a. This characterization is both inaccurate and legally irrelevant.

1. As a matter of fact and law, any claim that the Commission's action constituted "de facto deregulation" is nonsense. In Order 451, the Commission rejected proposals by several parties—including the Department of Justice—to deregulate old gas by removing all price controls. J.A. 170-71. Instead, the Commission set a maximum lawful price. It applied the "just and reasonable" standard, the classic tool of rate regulation. It found (correctly, in light of subsequent events) that the ceiling price it adopted would protect—indeed, benefit—consumers. See *supra* pp. 7-8 & note 3. And it retained full jurisdiction over rates so that, if necessary, it could change the regulatory system (including the rates themselves) to meet changed circumstances.

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[10] The Commission's estimate of replacement costs was based upon a study the Commission had performed in connection with Opinion No. 770, and whose application in that Opinion was affirmed on appeal. *American Public Gas Ass'n* v. *FPC*, 567 F.2d 1016 (D.C. Cir. 1977), *cert. denied*, 435 U.S. 907 (1978). See J.A. 84. In Order 451, the Commission simply updated the replacement cost estimate obtained in the Opinion 770 proceeding by the inflation factor set out in Section 104 of the NGPA (15 U.S.C. § 3311(a)). J.A. 84, 252-53.

The Commission's replacement cost analysis was supported by a second study submitted by natural gas producers. This study used the most recent available data to update each of the costing elements in the study used in Opinion No. 770, and therefore did not make any separate adjustment for inflation. See J.A. 88, 253-54. It produced a slightly higher estimate—$2.77 per MMbtu rather than $2.57. The Commission, however, adopted the lower figure. J.A. 93-94.

The mere fact that the ceiling price adopted in Order 451 exceeded the then-prevailing spot market price provides no basis whatever for concluding that the Commission was engaged in "de facto deregulation." The principal role of most ceiling prices—including that established by the Commission in this case—is not to keep prices artificially low, but simply to protect consumers from excessive prices resulting, for example, from unexpected world events or from a lack of competition. J.A. 82-83.[11] The very terms "*ceiling* price" and "*maximum* lawful price" themselves imply that the market price may be lower than the regulatory ceiling. This Court's *Mobile-Sierra* doctrine— which is incorporated in Section 101 (b)(9) of the NGPA (see 15 U.S.C. § 3311)—is built upon the assumption that market rates (as reflected in arm's-length contracts) will sometimes be below ceiling prices. See J.A. 222; see also *United Gas Pipe Line Co.* v. *Mobile Gas Serv. Corp.*, 350 U.S. 332, 343 (1956); *FPC* v. *Sierra Pacific Power Co.*, 350 U.S. 348, 353 (1956). Not surprisingly, therefore, ceiling prices have exceeded market prices many times during the history of natural gas regulation. See, *e.g.*, *FERC* v. *Martin Exploration Management Co.*, 486 U.S. 204, 209 (1988). Yet neither Congress nor any court (other than the court below) has ever suggested that such a result is tantamount to "deregulation."

Indeed, the ceiling price that Congress itself selected for the post-1974 old gas vintage when it enacted the NGPA has generally been higher than the spot market price since at least 1984.[12] Because the post-1974 old gas vintage did not magically become "deregulated" when the spot market price fell below the ceiling price for that

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[11] The GFN process, moreover, was expressly designed to assure that old gas is "priced at the *lower* of the market or the ceiling price . . . ." J.A. 142 (emphasis added). The NGPA expressly provides that ceiling prices do not displace lower market prices agreed to by private parties. 15 U.S.C. § 3311(b)(9).

[12] Compare 18 C.F.R. § 271.101 (Table II) (1990) with EIA Report, *supra* note 3, at 33 (Table 4).

vintage, *a fortiori* the Commission's decision to apply the post-1974 ceiling price to all vintages of old gas cannot be characterized as "deregulation."

2. In any event, whether the ceiling price is above or below any "market" price is legally irrelevant under the deferential standard of review applicable to Commission rate decisions. A Commission rate order must be affirmed as long as the "end result" of the order "cannot be said to be unjust and unreasonable." *Hope*, 320 U.S. at 602. Moreover, "[t]he court's responsibility is not to supplant the Commission's balance of . . . interests with one more nearly to its liking, but instead [is] to assure itself that the Commission has given reasoned consideration to each of the pertinent factors." *Mobil Oil Corp.* v. *FPC*, 417 U.S. at 308; see also *Permian*, 390 U.S. at 767, 792 (same). In this case, no one disputes that the Commission considered the relevant factors. Thus, regardless of whether the Commission's ceiling price is above or below any particular benchmark (including the market price), the only relevant question is whether the Commission's order produces an overall "end result" that is reasonable.

The "end result" of Order 451 is just and reasonable to producers and consumers alike. The Commission expressly found that the new ceiling price, which used the Commission's most conservative estimate of replacement cost (see *supra* note 10), was necessary to avoid skewing development and recovery efforts away from old gas. J.A. 24, 227-28. Specifically, the Commission found that this new ceiling would provide the market with 11 trillion cubic feet of old gas that otherwise would be lost forever, and that Order 451 would thereby save consumers approximately $25 billion. J.A. 16, 99, 259-60. The Commission also found that, although this new ceiling price might temporarily increase gas prices in a few regions where prices were artificially low, over the long run it would substantially reduce average prices to consumers. J.A. 114-25. In addition, the Commission found that other features of Order 451—such as its procedures for renegotiating outdated gas contracts (see *supra* pp. 10-11 &

note 4)—would further increase the supplies available to the market and thereby drive average prices even lower. J.A. 135-36.

These findings were not disputed by the majority below, which instead acknowledged that the end result of the Commission's order was "arguably meritorious." Pet. App. 25a. In fact, there could hardly be a more "meritorious" end result than the substantial decline in average gas prices to consumers since Order 451 went into effect. See *supra* note 3. And more important, the majority's conclusion deprived the court of appeals of any further reviewing authority: Any result that is "arguably meritorious" is, by definition, within the scope of the Commission's discretion under the just and reasonable standard, and therefore must be sustained under the end result test.

In short, the mere fact that the ceiling price adopted in Order 451 is higher than the then-prevailing spot market price is no basis for concluding that the Commission abused its discretion under the just and reasonable standard. A contrary holding—*i.e.*, that a ceiling price is impermissible merely because it exceeds a particular market price—would impose an arbitrary constraint, not only on the FERC's ratemaking powers, but also on the ratemaking powers of other regulatory agencies that regulate rates pursuant to a "just and reasonable" standard. See, *e.g.*, 47 U.S.C. § 205 (Federal Communications Commission); 49 U.S.C. § 10707 (Interstate Commerce Commission). Neither Congress nor this Court has ever suggested that a just and reasonable standard requires a ratemaking body to keep ceiling prices below market levels.

C. If Relevant At All, The Legislative History of the NGPA Fully Supports The FERC's Authority To Adopt The Old Gas Ceiling Prices It Adopted In Order 451.

The court of appeals sifted through the legislative history to find any support for its opinion that Congress, despite unambiguous language to the contrary, actually

meant to prevent the Commission from collapsing vintage pricing of old gas or from adopting a ceiling price in excess of the prevailing spot market price. The court's analysis of the legislative history is misguided in two respects. First, viewed fully and in context, the legislative history supports the Commission's interpretation. Indeed, it demonstrates that, aside from denying the Commission any authority to adopt ceiling prices lower than those specified in the NGPA (see *supra* note 9), Congress did not intend to circumscribe the Commission's traditional authority to set ceiling prices under the just and reasonable standard. Second, this Court's precedents forbid a reviewing court to rely solely upon legislative history—particularly legislative history that is at best ambiguous—to invalidate an agency's construction of its organic statute.

1. The majority relied primarily upon general remarks by members of Congress to the effect that the NGPA was not intended to abolish vintage pricing or to "deregulate" the interstate market for natural gas. Pet. App. 19a-22a & n.22. Aside from the fact that Order 451 did not "deregulate" the market for old gas (see *supra* pp. 23-26), the majority's reliance upon these remarks rests upon a fundamental logical error: Even though *Congress* did not eliminate vintage pricing in enacting the NGPA itself, it does not follow that Congress meant to strip *the Commission* of its traditional authority to respond flexibly to market conditions within the broad parameters of the "just and reasonable" standard.

The court below collapsed these issues when, for instance, it attributed to Senator Domenici the position that the "[e]limination of vintaging and deregulation of old gas [were] 'not doable' or 'ever suggested.'" Pet. App. 22a; see also *id.* (discussing statements by Sen. Jackson and Sen. Hart). Senator Domenici himself later pointed out, however, that he was addressing only claims that the NGPA represented legislative deregulation of old gas prices. J.A. 52 (letter to FERC). Moreover, he

specifically explained that the Commission retained the power to eliminate vintage pricing:

> It is my own belief that vintaging has been and continues to be a matter of policy for and by the Commission. That was the law under the NGA, and that was the state of the law at the time Congress adopted the NGPA. As such, *the Commission is free to change it—or even terminate it—at the option of a majority of the Commissioners.* Nothing in the legislative history and particularly nothing in my own statements, can be read to inhibit the Commission if it chooses to exercise that freedom.

Id. (emphasis added). See *Gwaltney of Smithfield, Ltd. v. Chesapeake Bay Found., Inc.*, 484 U.S. 49, 62-63 (1987) (legislator's statement must be viewed "in context").

Several other members of Congress explicitly affirmed the Commission's broad discretion under the "just and reasonable" standard, incorporated in both the NGA and the NGPA, to adjust the ceiling prices of old gas as it saw fit. During the Senate debate on the Conference Report, for example, Senator Abourezk observed that nothing in the NGPA "prevents FERC setting the rate at whatever level is necessary actually to elicit new supply." 124 Cong. Rec. S30,018 (September 19, 1978). Senator Kennedy added:

> I want to remind Senators that the means of increasing production is already available in the form of the Federal Energy Regulatory [Commission]. Sufficient authority already exists to establish prices which will bring forth gas at a "just and reasonable" price and to vary that price according to conditions.

Id. at S30,023. Such observations refute the assertion below that Congress, by acknowledging its own unwillingness to alter the vintage pricing system in 1978, meant to narrow the Commission's traditional authority under the just and reasonable standard to set new prices for old gas in light of changing circumstances. Such an extraor-

dinary restriction on the Commission's ability to ensure just and reasonable prices would require much clearer evidence than that cited by the majority below.

The court below also cited very general comments in the legislative history to the effect that natural gas regulation should protect the consuming public. Pet. App. 20a-21a & n.22. As this Court has recently held, however, "unenacted approvals, beliefs, and desires are not laws." *Puerto Rico Dept. of Consumer Affairs* v. *Isla Petroleum Corp.*, 485 U.S. 495, 501 (1988); cf. *United Savings Ass'n* v. *Timbers of Inwood Forest Assocs.*, 484 U.S. 365, 380 (1988) ("generalizations" in legislative history "are inadequate to overcome plain textual indication[s]"). The comments relied upon by the majority, moreover, are much too vague to override the Commission's expert opinion on the kind of regulatory system that will best protect consumer interests. Those comments certainly do not foreclose Order 451, which, as FERC prophetically concluded, protects consumers *better* than the economically obsolete vintage pricing system. In fact, such general congressional invocations of consumer interests, without more, merely underscore the Commission's claim that it—and not a reviewing court—has the institutional expertise to protect those interests. In short, nothing in the NGPA's legislative history casts any doubt upon the validity of Order 451's pricing provisions.

2. But even if the majority's reading of the NGPA were supported by some snippet of legislative history, it would be irrelevant. In *K Mart Corp.* v. *Cartier, Inc.*, 486 U.S. 281 (1988), this Court specified the evidence that courts may use to ascertain both "the unambiguously expressed intent of Congress" and the range of permissible statutory interpretations for purposes of the two-step analytical framework set out in *Chevron*. Under *K Mart*, the only appropriate evidence for either inquiry is the "language[] of the statute." *Id.* at 291, 292. The Court declared: "If the agency regulation is not in

conflict with the plain language of the statute, a reviewing court must give deference to the agency's interpretation of the statute." *Id.*; see also *Chevron*, *supra*, 467 U.S. at 843 ("legislative regulations are given controlling weight unless they are arbitrary, capricious, or manifestly contrary to the statute"); *Atkins* v. *Rivera*, 477 U.S. 154, 162 (1986) (same). In sum, a reviewing court may not use extra-textual speculation to invalidate an agency's reasonable statutory interpretation.

The majority below did just that. As previously shown (*supra* pp. 17-27), neither of the two pricing features of Order 451—its decision to collapse vintage pricing of old gas or its impostion of a ceiling price based upon a replacement cost approach—is in any way "in conflict with the plain language of the statute." *K Mart*, 486 U.S. at 292. Thus, the court below erred in relying upon its own interpretation of the legislative history to invalidate that order.[19]

In sum, Congress unambiguously authorized the Commission to adjust ceiling prices upward in any manner the Commission considered appropriate under the "just and reasonable" standard of the NGA. In Order 451, the Commission set a ceiling price strictly in accordance with the authority conferred in Sections 104 and 106: the price was higher than (or equal to) the NGPA ceilings; and it is "just and reasonable" as that phrase has been interpreted in this Court's precedents. Accordingly, it is the majority below, not the Commission, that has exceeded its authority by striking down an entire regulatory system based on nothing more than its own view of what Congress "intended"—but did not enact—in the NGPA. This Court should hold that the ceiling price set by the

[19] In any event, the most that the items cited by the majority conceivably could establish is that the legislative history is ambiguous. In that circumstance, *Chevron* requires a reviewing court to defer to the Commission's reasonable interpretation, even if legislative history can appropriately be considered in this context. See *supra* p. 30.

Commission was fully consistent with the requirements of the NGPA, and it should reverse the court of appeals' contrary holding.

II. THE FERC HAS AMPLE AUTHORITY UNDER SECTION 7(b) OF THE NGA TO PERMIT ABANDONMENTS GENERICALLY, WITHOUT CASE-BY-CASE ADJUDICATION.

In reviewing the abandonment provisions of Order 451, it is important to bear in mind what is and what is not at issue before this Court. The only question presented in this case is whether Order 451's abandonment *procedure* complies with the *procedural* requirements of Section 7(b). The substantive abandonment standard applied in Order 451—*i.e.*, the standard by which the Commission determined that the abandonments approved in that order would satisfy the "public convenience and necessity" requirement of Section 7(b)—is not at issue here. That standard is known as the "overall needs of the market" standard, and was adopted in *Felmont Oil Corp. and Essex Offshore, Inc.*, 33 FERC ¶ 61,333 at 61,657 (1985), *rev'd and remanded on other grounds sub nom. Consolidated Edison Co.* v. *FERC*, 823 F.2d 630 (D.C. Cir. 1987). There, the Commission rejected its prior "comparative needs" approach, which looks to the relative need for the gas of the existing customer and the customer who would be served if abandonment were granted, and determined instead that abandonment is proper if it serves the "overall needs of the market." See J.A. 147, 303. This standard has been repeatedly affirmed in the lower courts. See, *e.g.*, *Pennsylvania Public Utility Comm'n* v. *FERC*, 881 F.2d 1123, 1127 (D.C. Cir. 1989) (citing cases). In the court below, respondents did not challenge either that substantive standard or the Commission's decision to apply it in this case.

The plain language of Section 7(b) imposes only three procedural requirements for a lawful abandonment of a service or facility subject to the FERC's jurisdiction.[14] First, the FERC must approve the abandonment. Second, the Commission must make a finding "that the present or future public convenience or necessity permits such abandonment." Third, the Commission may grant its approval only "after due hearing."

Order 451's abandonment procedures satisfy each of these requirements. First, the Commission expressly approved the abandonment. J.A. 147. Second, the Commission found that the public convenience and necessity permitted abandonment whenever a producer was unable to reach agreement with its pipeline customer on a new price. *Id.* This finding was based upon the Commission's expert judgment that the natural gas market as a whole would benefit from the increased gas supplies that would be created by the "release" to the market of the gas so affected. It is well established that "legislative facts" may be found—and determinations of the "public convenience and necessity" may be made—in a rulemaking as well as in an adjudication. *E.g.*, *Heckler* v. *Campbell*, 461 U.S. 458, 467 (1983); *FCC* v. *WNCN Listeners Guild*, 450 U.S. 582, 593-594 (1981); *FPC* v. *Texaco Inc.*, 377 U.S. 33, 41-44 (1964).

Third, prior to granting abandonment and in connection with the rulemaking that led to Order 451, the Commission held both an extensive "notice and comment hearing" and an oral hearing. See *supra* p. 7. Such procedures, even without public hearings, have been held to satisfy the "hearing" requirements of numerous other federal statutes. See *United States* v. *Florida E.C. Ry.*, 410 U.S. 224, 239-46 (1973) (statutory "hearing" requirement satisfied by rulemaking); *United States* v. *Allegheny Ludlum Steel Corp.*, 406 U.S. 742, 756-58 (1972) (same); *FPC* v. *Texaco Inc.*, 377 U.S. at 41-45 (same); *United States* v. *Storer Broadcasting Co.*, 351 U.S. 192 (1956) (same); see also K. Davis, *Administra-*

[14] "Abandonment," as used here, refers to the procedure by which any entity subject to the NGA, whether a producer or pipeline, is

tive Law Treatise, § 12:16 (2d ed. 1979).[15] The Commission, moreover, expressly found that any case-by-case fact-finding procedure would effectively destroy the GFN process because it would permit pipelines to prevent the reallocation of old gas by initiating proceedings which would inevitably lead to substantial regulatory delays.[16]

The court of appeals nonetheless held that, "in the instant case, the Commission has abdicated its responsibility under Section 7(b) of the NGA by providing for an across the board, pre-authorized abandonment provision." Pet. App. 29a. Although the precise basis for this holding is not entirely clear, it appears to rest upon two conclusions: (1) by virtue of Section 7(b)'s "due hearing" requirement, the Commission lacks authority to grant abandonment generically, *i.e.*, without any "factual inquiry into the circumstances" of each abandonment (*id.*; see also *id.* at 28a n.29); and (2) the Commission's procedures are inadequate because they "allow a pro-

relieved of a service obligation under that statute. Thus, gas that is "abandoned" under Order 451 does not disappear or remain unproduced, but rather is "released" into the national gas market. See J.A. 21-23.

[15] Indeed, respondents conceded below that the "due hearing" provision of Section 7(b) does not require formal, trial-type hearings. Reply Brief of Joint Opponents, 16-18, No. 86-4940 (5th Cir.).

[16] As the Commission explained in Order 451:

> [I]t would make no sense for the Commission to require individual producers to file abandonment applications and to hold a hearing on each application. Since there are thousands of producers of old gas, that procedure could result in a vast proliferation of hearings. Given the Commission's limited resources, the inevitable result would be lengthy delays before individual abandonments could be granted. This would seriously impede the achievement of this rule's goals of increasing production of old gas and reducing overall prices.

J.A. 148. Indeed, it was for similar reasons that this Court held in *Permian* that the Commission is not required by Section 4 of the NGA to set ceiling rates on a producer-by-producer basis. See 390 U.S. at 769.

ducer, for all practical purposes, to control abandonment" and are therefore contrary to this Court's decision in *McCombs*. *Id.* at 29a; see also *id.* at 29a-30a (same).[17] Neither of these objections provides any basis for holding that the Commission's interpretation of its own statute is contrary to the procedural requirements of Section 7(b).

A. Section 7(b)'s "Due Hearing" Provision Does Not Require Case-By-Case Inquiry Into Each Abandonment.

The short answer to the majority's claim that the Commission failed to comply with Section 7(b)'s "due hearing" requirement is that the Commission did, in fact, hold both a notice and comment hearing and an oral hearing in conjunction with the rulemaking process that led to Order 451. See *supra* p. 7. Thus, the only question is whether, as the Commission held (see J.A. 147-48, 308-09), the "due hearing" requirement is satisfied by a hearing held in conjunction with a generic rulemaking, or whether, as the court of appeals majority believed (see Pet. App. 29a-30a), the "due hearing" requirement mandates a case-by-case inquiry into the circumstances of each abandonment. The Commission's interpretation is not only reasonable, but also correct. It is fully supported by the plain language of the statute, by this Court's prior interpretations of Section 7(b) and other analogous statutes, and by the principles that underlie

[17] The court of appeals' decision can also be read as holding that FERC lacks authority under Section 7(b) to grant abandonment in advance, *i.e.*, to "pre-grant" (*id.* at 28a, 29a) or "pre-authorize[]" (*id.* at 29a) abandonment. But any such holding is squarely foreclosed by this Court's decision in *FPC* v. *Moss*, 424 U.S. 494 (1976). The Commission rule at issue there permitted the Commission to "pre-grant" abandonment at the same time as it granted permission to initiate service. Like Order 451, the purpose of the rule was to "stimulate domestic exploration and development of natural gas reserves." *Id.* at 497. This Court upheld the rule, squarely rejecting the argument that "§ 7(b) requires a public-convenience-or-necessity finding by the [Commission] at the time of the proposed abandonment." *Id.* at 499.

this Court's decision in *Vermont Yankee Nuclear Power Corp.* v. *NRDC*, 435 U.S. 519 (1978).

1. The plain language of Section 7(b) is dispositive for two independent reasons. First, the word "hearing" is flexible. It encompasses a generic hearing held in conjunction with a rulemaking, a formal trial-type hearing held in conjunction with an adjudication, and anything in between. See, *e.g.*, K. Davis, *Administrative Law Treatise* §§ 12.10, 12.16. An agency's choice among these alternatives may be overturned only if it is arbitrary and capricious. *E.g.*, *Heckler* v. *Campbell*, 461 U.S. at 466-67. This choice, moreover, necessarily depends in large part upon the substantive standard being applied: A standard that turns upon concrete, specific facts (such as whether one customer or another has a greater need for a particular quantity of natural gas) generally calls for some kind of case-by-case, adjudicatory inquiry. On the other hand, a standard that turns upon broad policy judgments or upon "legislative facts" (such as whether the "market as a whole" will benefit from abandonment in certain kinds of situations) is more amenable to a generic hearing. See Davis, *supra*, § 14.3.

In this case, the Commission correctly concluded that, under the "overall needs of the market" standard, there would be no need for a case-by-case inquiry because all relevant factual questions could be resolved (and were being resolved) in the hearing the Commission had undertaken as part of the rulemaking. J.A. 147-48, 308-09. The majority below did not even dispute this conclusion, much less hold it arbitrary and capricious. The majority's rigid requirement that the Commission nonetheless must hold a case-by-case inquiry into each abandonment is inconsistent with the flexibility contained in the phrase "due hearing." [18]

[18] See also *Panhandle Eastern Pipe Line Co.* v. *FERC*, No. 89-1354, slip op. at 6 (D.C. Cir. June 29, 1990) (there is "no procedural objection to the Commission's identification of circumstances, in an otherwise valid rulemaking, which automatically trigger its approval

Second, the plain language of Section 7(b) commits to the Commission (rather than a reviewing court) the authority to determine the type of hearing that is "due" in any particular case. For that reason, Section 7(b) is a classic example of a statutory provision that calls for *Chevron*-style deference to the interpretation of the agency administering the statute. See, *e.g.*, *Chevron*, 467 U.S. at 843-44; see also *Drummond Coal Co.* v. *Hodel*, 796 F.2d 503, 507 (D.C. Cir. 1986), *cert. denied*, 480 U.S. 941 (1987) (Congress leaves gap for agency to fill when it does not "explicitly address the proper meaning of the words" used in statute). Thus, if there were any doubt as to whether Section 7(b)'s "due hearing" requirement encompasses a generic rulemaking hearing, the only question for this Court "is whether the agency's answer is based on a permissible construction of the statute." *Chevron*, 467 U.S. at 843.

FERC's "answer" easily satisfies this standard. In Order 451, the FERC expressly interpreted Section 7(b) to permit a generic rather than case-by-case inquiry, and it held that the only hearing that is "due" in this case is the rulemaking proceeding that led to Order 451. See J.A. 308-09. That interpretation is certainly a reasonable construction of the statutory language: Nothing in the language or legislative history of Section 7(b) prohibits the Commission from relying upon a rulemaking proceeding to satisfy Section 7(b)'s "due hearing" requirement or from making its public convenience finding on a generic rather than individual basis, particularly when no issues of fact are in dispute. *E.g.*, *FPC* v. *Texaco Inc.*, 377 U.S. 33, 39-41 (1964). To the contrary, the settled meaning of the term "hearing" encompasses notice-and-comment rulemaking procedures. See *supra* p. 36. Under *Chevron*, therefore, the Commission's interpretation must be upheld.

of abandonment") (quoting *AGD* v. *FERC*, 824 F.2d 981 (D.C. Cir. 1987), *cert. denied*, 485 U.S. 1006 (1988)).

2. The court of appeals' argument that Section 7(b) requires a case-by-case inquiry into every abandonment is also directly contrary to this Court's precedents. *First*, this Court has frequently held that an agency may satisfy "hearing" requirements contained in other statutes through rulemaking rather than case-by-case inquiry. In *FPC* v. *Texaco*, for example, this Court held that the Commission need not hold a case-by-case hearing under Section 7(c) of the NGA, pertaining to certificates of public convenience and necessity, if in a previous rulemaking proceeding the Commission had determined that it would automatically deny certificate applications containing impermissible pricing provisions. 377 U.S. at 39-41. The Court declared that "the statutory requirement for a hearing under Section 7 does not preclude the Commission from particularizing statutory standards through the rulemaking process and barring at the threshold those who [do not] measure up to them." *Id.* at 39. See also *Shell Oil Company* v. *FPC*, 520 F.2d 1061, 1074-75 (5th Cir. 1975), *cert. denied*, 426 U.S. 941 (1976) (nationwide ratemaking process by rulemaking did not violate hearing provisions of APA).

Similarly, this Court held in *United States* v. *Storer Broadcasting Co.*, 351 U.S. 192, 205 (1956), that the Federal Communications Commission may summarily deny certain license applications under § 309(b) of the Federal Communications Act, without a fact-finding hearing, on the basis of standards established in rulemaking proceedings. The Court reached this conclusion even though Section 309(b) by its terms requires the agency to "formally designate the application for hearing" before the application can be denied. *Id.* at 195-96 n.5. If a regulatory agency has authority not to hold a case-by-case inquiry when the statute by its terms appears to require one, *a fortiori* the agency has that authority when the statute explicitly gives it discretion to determine what kind of "hearing" is "due."

Second, the majority's interpretation of Section 7(b), requiring a case-by-case inquiry with respect to each

abandonment, is contrary to the reasoning of *FPC* v. *Moss*, 424 U.S. at 496. The rationale for a case-by-case inquiry is that it ensures that the Commission's judgment about the merits of the abandonment will be based upon presently verifiable facts rather than generalized judgments. See Respondents' Brief in Opposition to Certiorari at 26. In *Moss*, however, this Court held that Section 7(b) permits the Commission to authorize abandonment years before the abandonment is to take place. That holding necessarily means that the Commission may rely upon predictive judgments about the likely effects of an abandonment—such as its effects on the "overall needs of the market"—rather than presently verifiable facts. See also *FPC* v. *Transcontinental Gas Pipe Line Corp.*, 365 U.S. 1, 29 (1961); *FCC* v. *RCA Communications, Inc.*, 346 U.S. 86, 96-97 (1953); *United States* v. *Detroit & Cleveland Navigation Co.*, 326 U.S. 236, 241 (1945). Given that *Moss* permits the Commission to rely solely upon general, predictive judgments about the likely effects of an individual abandonment, there is no reason why the Commission should not be permitted to rely upon general, predictive judgments about the likely effects of a *class* of abandonments, at it did here.[19]

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[19] In the court below and in their opposition to certiorari, respondents also relied upon *United Gas Pipe Line Co.* v. *McCombs*, 442 U.S. 529 (1979), in support of their argument that Section 7(b) requires a fact-specific inquiry with respect to each abandonment. Any such reliance is misplaced. The holding of *McCombs* is that any abandonment must have Commission approval to be lawful under Section 7(b), not that the Commission must conduct a fact-specific inquiry. 442 U.S. at 537. And *McCombs* did not hold that the Commission is *precluded* from making an abandonment decision based upon "a hypothetical set of facts," as respondents have claimed. See Respondents' Brief in Opposition to Certiorari at 26 (quoting 442 U.S. at 540). Rather, the Court held that the Commission "did not abuse its *discretion* in declining" to grant abandonment retroactively, in part because retroactive approval would require the Commission "to determine on a hypothetical set of facts what action it would have taken" if an application had been filed prior to abandonment. 442 U.S. at 540 (emphasis

3. Given the complete absence of statutory support for its position, the court of appeals' argument that the Commission must examine each abandonment individually flouts the general principles underlying *Vermont Yankee Nuclear Power Corp.* v. *NRDC*, 435 U.S. 519 (1978). There, this Court warned reviewing courts against "engrafting their own notions of proper procedures upon agencies entrusted with substantive functions by Congress." *Id.* at 525. The procedural requirement that the court below engrafted onto Section 7(b) undermines the Commission's decisionmaking process in two essential respects.

First, the authority to exercise its powers generically is critical to the Commission's ability to carry out its regulatory mission. The Commission has traditionally employed broad regulatory measures akin to Order 451 in response to large swings in the price and supply of the Nation's natural gas.[20] In this case, moreover, the Commission expressly found that case-by-case factual inquiries would destroy the effectiveness of Order 451 in fostering competition and thereby increasing the supply of natural gas. See *supra* note 16. As it was in *Permian*, this Court should be reluctant to "prohibit administrative action imperative for the achievement of an agency's ultimate purposes." 310 U.S. at 780.

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added). Thus, *McCombs* itself confirms that the procedures to be used in determining the propriety of abandonment rest squarely within the Commission's discretion.

[20] In Order 436, for example, the Commission imposed an "open access" requirement upon all pipelines wishing to transport gas under a blanket certificate under Section 7(c) of the NGA, without conducting any inquiry into whether such a requirement would be justified on the basis of specific facts and circumstances. 50 Fed Reg. 42,408 (1985), *vacated and remanded on other grounds sub nom. Associated Gas Distributors* v. *FERC*, 824 F.2d 981, 1008 (D.C. Cir. 1987), *cert. denied*, 485 U.S. 1006 (1988). See also *Wisconsin Gas Co.* v. *FERC*, 770 F.2d 1144 (D.C. Cir. 1985), *cert. denied*, 476 U.S. 1114 (1986) (upholding FERC Order 380 summarily striking "minimum bill" provisions from contracts between pipelines and their wholesale customers).

Second, the case-by-case inquiry requirement imposed by the court of appeals would serve no purpose beyond delay. Unlike the Commission's prior "comparative needs" standard, the "market as a whole" standard applied in Order 451—and not challenged in the court below—does not turn upon the facts surrounding each individual abandonment. See *supra* p. 32. Thus, to require that the Commission make an inquiry into the facts of each abandonment permitted by Order 451 is to require either (a) that the Commission modify or overrule its concededly proper substantive abandonment standard, or (b) that for each case it conduct a useless, time-consuming inquiry that will have no bearing upon any ultimate decision.[21] But a reviewing court may not force the Commission to change its abandonment standard under the guise of a "procedural" requirement without a finding (which was not even sought by respondents below) that the standard itself is arbitrary and capricious or otherwise unlawful. And the principles of *Vermont Yankee* plainly preclude the imposition of a procedural requirement not clearly mandated by the agency's organic statute. As this Court explained in *Texaco*,

> To require the Commission to proceed only on a case-by-case basis would require it . . . to repeat in hearing after hearing its conclusions that condemn all of [the applications covered by the generic order] . . . . We see no reason why under this statutory scheme the processes of regulation need be so prolonged and so crippled. 377 U.S. at 44 (citations omitted).

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[21] Of course, nothing in Order 451 precludes a hearing if factual disputes arise as to whether the requirements for abandonment—compliance with the GFN procedure—have been satisfied. J.A. 295-97. The 30-day notice requirement in the GFN procedure (*id.* at 296) is ample time to permit a purchaser to file a complaint under the Commission's rules. See 18 C.F.R. § 385.206. To petitioners' knowledge, however, no one has ever filed a complaint or sought a hearing on the ground that either a producer's or a pipeline's alleged failure to comply with the GFN requirements rendered a proposed abandonment unlawful.

Accord *Heckler* v. *Campbell*, 461 U.S. at 467. Nothing in the language or history of Section 7(b) provides any more reason to impose a case-by-case inquiry requirement here.

B. Order 451's Abandonment Procedure Cannot Be Invalidated Based Upon A Reviewing Court's Judgment That It Gives The Producer Excessive Control Over The Abandonment Decision.

The court of appeals also read this Court's decision in *McCombs* as foreclosing the Commission's use of its abandonment authority under Section 7(b) whenever, *in the opinion of a reviewing court*, the procedures leading to abandonment "appear" to give undue "control" over the abandonment decision to the producer. The majority's analysis is both legally irrelevant and factually incorrect.

1. The majority's "excessive producer control" analysis is incorrect as a matter of law, for three reasons. First, it rests upon a misinterpretation of *McCombs*. *McCombs* involved a blatant attempt to circumvent the plain language of Section 7(b) requiring Commission approval for an abandonment. 442 U.S. at 537. In explaining why *Congress* had imposed that requirement, this Court noted that, without Commission approval, "the abandonment determination would rest, as a practical matter, in the producer's control, a result clearly at odds with Congress's purpose to regulate the supply and price of natural gas." *Id.* at 539. But this passage neither suggests nor holds that a reviewing court may second-guess an express grant of abandonment by the Commission, made under a permissible substantive standard, on the ground that the conditions imposed by the Commission give the producer undue control over the abandonment decision. See also *Panhandle Eastern Pipe Line Co., supra*, slip op. at 6 (expressly disagreeing with interpretation of *McCombs* by majority below).

Second, the majority's interpretation of *McCombs* would require this Court to overrule *Moss*. As Chief Justice Burger pointed out in that case, the pre-authorized abandonment procedure approved in *Moss* gave the producer *complete* discretion to determine, at the expiration of its contract with the customer, whether to abandon service or to continue it on the same terms. *FPC* v. *Moss*, 424 U.S. 494, 505 (1976) (Burger, C.J., concurring). In contrast to Order 451 (see *infra* pp. 45-46), the rule at issue there provided *no* mechanism by which the customer could force the producer to continue service. *Id.* at 505-06. If, as the majority suggested, Section 7(b) required a reviewing court to invalidate any particular pre-granted abandonment mechanism that gives "too much" control to a producer, the mechanism approved in *Moss* would plainly have been invalid. But nothing in *McCombs* suggests that the Court was attempting *sub silentio* to overrule *Moss*.

Third, the majority's reading of *McCombs* would require this Court to ignore well-established principles of statutory construction. In the majority's view, Congress's "purpose" (Pet. App. 30a) was to ensure that the Commission not only would determine whether an abandonment is legally *permissible* (which it obviously did here with respect to all abandonments that occur pursuant to Order 451), but also would exercise sufficiently close supervision so that it, rather than the producer or the pipeline, would "for all practical purposes . . . control" whether each individual abandonment actually occurs. Pet. App. 29a. But nothing in the language of Section 7(b) supports the imposition of this additional requirement on the Commission. For that reason, the majority's "excessive producer control" argument contravenes this Court's consistent teaching that a statute's terms cannot properly be limited or expanded solely with reference to a reviewing court's opinion of the general congressional purpose that underlies the statute. *Rodriguez* v. *United States*, 480 U.S. 522, 526 (1987); *Aaron* v. *SEC*, 446 U.S. 680, 695 (1980); *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 214 n.33 (1976). And, because the Commission expressly and reasonably rejected this interpretation of Section 7(b) (see J.A. 306-07), the majority's at-

tempt to engraft an "excessive producer control" limitation on that provision is also contrary to the deference principles embodied in *K Mart* and *Chevron*. See *supra* p. 17.

In short, the court of appeals erred in construing *McCombs* to hold that a reviewing court may substitute its judgment for the Commission's whenever it concludes that a particular abandonment procedure gives "too much" control to the producer. Congress has entrusted such policy judgments to the Commission, not the judiciary. *E.g.*, *Chevron*, *supra*, 467 U.S. at 864 ("policy arguments are more properly addressed to legislators or administrators, not to judges"); *PBGC* v. *LTV Corp.*, No. 89-390, slip op. at 16 (June 18, 1990) ("judgments about the way the real world works that have gone into the [agency's] policy are precisely the kind that agencies are better equipped to make than are the courts").

2. Although not relevant to the legal issues before this Court, the majority's views about the GFN procedure are simply incorrect. The GFN procedure is by no means "one sided," as the majority erroneously claimed.[22] Nor does it give the producer "undue" control over the abandonment decision. As this Commission found, abandon-

[22] This claim ignores the Commission's determination, after careful study, that market forces would operate to reduce the purchasers' high-cost gas burdens because gas "released" to the national gas market under Order 451 would increase supplies and thereby drive overall prices down. J.A. 119-36, 147, 319-21. It also ignores the fact that the GFN procedure permits pipelines to escape contractual obligations to purchase gas they no longer want. And it ignores the fact that the GFN process allows a pipeline to abandon its purchase of any high-cost gas covered by contracts that also provide for the sale of old gas (*i.e.*, "multivintage" contracts). J.A. 150. Finally, it ignores the fact that the GFN procedure expressly gives the customers of a non-"open access" pipeline a right of first refusal to purchase the gas released as a result of the GFN procedure. J.A. 154-55. For these reasons, the Commission reasonably determined that the GFN procedure was balanced and fair to pipelines, producers and end users alike. J.A. 153-55, 319-25.

ment can occur under the GFN procedure "only through the parties' *mutual* exercise of their rights" under that procedure. J.A. 312 (emphasis added); see also J.A. 321. To be sure, the producer must initiate the process. But once it is initiated, Order 451 permits abandonment only on two conditions, both of which are largely in the pipeline's control.

First, no abandonment can occur unless the pipeline refuses to offer an acceptable below-ceiling price that reflects the market value of gas sold under a contract that is comparable (in duration, for example) to the pipeline's contract with the producer. As the Commission found, a producer "is unlikely to sell to another purchaser unless it finds one willing to offer a better bargain than the existing purchaser." J.A. 153. In practice, moreover, the vast majority of pipelines have been able to negotiate market prices for the gas they wished to retain—and to release gas that they deemed to be in excess of their system requirements—*without* any resort to the GFN procedure. *E.g.*, *Natural Gas Policy Act: Hearings on H.R. 1595 Before The Subcomm. On Energy And Power Of The House Committee On Energy And Commerce*, 101st Cong., 1st Sess. 156 (April 5, 1989). That outcome is consistent with the Commission's prediction—and stated desire—that the formal GFN procedure would be unnecessary in most cases. *E.g.*, J.A. 163, 296.

Second, even if the parties are unable voluntarily to agree on a new price, no abandonment can occur unless the pipeline refuses to purchase the gas at the price provided in its contract with the producer. The only circumstance in which the producer may invoke the GFN procedure at all is where the contract between the producer and the pipeline contains a price escalation provision that pegs the contract price to the alternative maximum price adopted by the Commission. J.A. 149.[23]

[23] Understood in that light, the GFN procedure substantially *limits* the producer's well-established right to seek abandonment of

The GFN procedure, in turn, permits abandonment only when the pipeline does not offer to buy the gas at the new contract price. J.A. 149, 296, 321. If the pipeline offers to pay the contract price, it has an absolute right to retain the gas. Thus, as the Commission expressly found, any abandonment of service under the GFN procedure "results from the *purchaser's* decision to offer a price lower than that provided by the contract." J.A. 312 (emphasis added).

It is thus simply absurd to claim, as the majority did, that Order 451 "allow[s] a producer . . . to control abandonment. . . ." Pet. App. 29a. But if there were any doubt on the matter (and if the question were legally relevant, see *supra* pp. 42-44), the Commission's contrary conclusion is entitled to the utmost deference, see *Chevron*, *supra*, 467 U.S. at 864; *PBGC* v. *LTV Corp.*, *supra*, slip op. at 16; and can be reversed only if it is irrational or arbitrary, see, *e.g.*, *Bureau of Alcohol Tobacco & Firearms* v. *FLRA*, 464 U.S. 89, 98 n.8 (1983). The court of appeals failed to demonstrate that the Commission's assessment was even arguably incorrect, much less irrational.

III. FERC NEED NOT RESOLVE THE TAKE-OR-PAY ISSUE AS A PRECONDITION TO ITS EFFORTS TO RESOLVE THE PROBLEM OF OLD GAS PRICING.

The court below erred in suggesting that the Commission must resolve the take-or-pay issue as a prerequisite to its efforts to deal with the pricing of old gas.[24]

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the producer's service obligation—and to sell the gas so "released" to another customer—whenever a customer refuses to pay the contract price. See, *e.g.*, *National Fuel Gas Supply Corp.*, 48 FERC ¶ 61,195 (1989) (granting abandonment because, *inter alia*, purchaser failed to pay contract price); *Northern Natural Gas Co.*, 41 FERC ¶ 61,116 at 61,279 (1987) (same).

[24] In their opposition to certiorari, respondents vigorously contended that the court of appeals' discussion of the take-or-pay issue was merely precatory. See Respondents' Opposition to Certiorari at 28-29 (filed May 14, 1990). Petitioners would accept that characterization of the decision below, so long as it is clear from this Court's decision that the Commission is not obligated to address further or to resolve the take-or-pay issue as a condition of Order 451's validity.

The court simply ignored the Commission's determination (J.A. 67-68, 293-95), that the take-or-pay issue is better addressed in the ongoing proceedings devoted entirely to that issue.[25]

It is well established that whether an agency must address discrete regulatory concerns in the same proceeding is a matter firmly committed to the discretion of the agency, not a reviewing court. This Court's decision in *FPC* v. *Sunray DX Oil Co.*, 391 U.S. 9, 49 (1968), which specifically affirmed the FPC's discretion to address take-or-pay issues in one set of proceedings rather than another, is a classic illustration of this principle. That principle comports with the Court's traditional deference both to an agency's choice of rulemaking procedure, see *Vermont Yankee Nuclear Power Co.* v. *NRDC*, 435 U.S. 519, 543-54 (1978), and to an agency's generally unreviewable discretion to manage its priorities as it sees fit, see *Heckler* v. *Chaney*, 470 U.S. 821, 831-32 (1985). It also comports with practical necessity: As this Court has long recognized with respect to legislative action, "[e]vils in the same field may be of different dimensions and proportions, requiring different remedies. . . . [T]he reform may take one step at a time, addressing itself to the phase of the problem which seems most acute to the legislative mind." *Williamson* v. *Lee Optical of Oklahoma, Inc.*, 348 U.S. 483, 489 (1955); see also *Schweiker* v. *Wilson*, 450 U.S. 221, 238 (1981).

Accordingly, an agency's discretion to order its priorities as it wishes (see *Heckler*, 470 U.S. at 831-32) should be limited, if at all, only when two issues are so inex-

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[25] As previously noted, the Commission is addressing the take-or-pay issue in its Order 436/500 proceedings. See *American Gas Ass'n* v. *FERC*, 888 F.2d 136 (D.C. Cir. 1989); *Tennessee Gas Pipeline Co.* v. *FERC*, 871 F.2d 1099, 1106 (D.C. Cir. 1989); Pet. App. 56a (Brown, J., dissenting).

tricably related that separate treatment would pose an almost certain risk of inconsistent standards or outcomes.[26] The court below, however, did not find (and could not have found) that the take-or-pay issue was so inextricably related to the problem of old gas pricing that the latter could not rationally be addressed without resolving the former. The closest the majority came was the unsupported and irrelevant contention that Order 451 "exacerbat[es]" the take-or-pay issue. Pet. App. 33a.

The Commission, however, reasonably concluded that Order 451 would do far more to resolve the take-or-pay issue than it would do to exacerbate it. J.A. 114-23, 287-95. By increasing the price of some old gas, Order 451 may raise the price that some pipelines must pay under some take-or-pay provisions. See, *e.g.*, J.A. 294. But, by increasing the overall supply of natural gas, Order 451 will decrease the overall market price of all gas, and thereby reduce the pipelines' aggregate liability on most take-or-pay obligations. See J.A. 293-94. In addition, Order 451 provides powerful incentives for producers and pipelines to reduce take-or-pay obligations voluntarily.[27]

[26] That is the standard employed, for example, by the D.C. Circuit. *E.g.*, *Wisconsin Gas Co. v. FERC*, 770 F.2d 1144, 1159-60 (D.C. Cir. 1985), *cert. denied*, 476 U.S. 1114 (1986) (upholding FERC's discretion not to address take-or-pay issue in "minimum bill" proceeding); *Neighborhood TV Co.* v. *FCC*, 742 F.2d 629, 642-43 (D.C. Cir. 1984) (upholding FCC's discretion to separate its consideration of two related but discrete issues); see also *ITT World Communications, Inc.* v. *FCC*, 725 F.2d 732, 754 (D.C. Cir. 1984).

[27] First, "since there will no longer be an old-gas cushion available to protect high-priced contracts through rolled-in-pricing, both pipelines and producers will find it mutually advantageous to renegotiate such contracts in order to retain a market for their supplies in the face of competition from cheaper gas and alternate fuels." J.A. 121-22. Second, for multi-vintage contracts containing old gas, FERC's GFN process effectively enables a pipeline to refuse to pay more for old gas unless the producer reduces or eliminates the pipeline's take-or-pay obligations. See J.A. 122, 293-94.

But even if, contrary to the conclusion of the expert agency charged with making such judgments, the elimination of vintage pricing does "exacerbate" the take-or-pay issue, it does not follow that the agency must undertake to resolve both issues in the same proceeding. The fact that a regulatory program designed to resolve one important problem might "exacerbate" another problem does not mean that the agency is thereby disabled from resolving the first problem without simultaneously resolving the second. See, *e.g.*, *Neighborhood TV Co.*, 742 F.2d at 643 (even though FCC licensing of low power TV stations interfered with sheriff's radio communications, agency could defer resolution of that problem to another proceeding). Because the economic interrelationships within a regulated industry are frequently both extensive and complex, a contrary view would reduce regulatory agencies to paralysis. Cf. *Heckler*, 470 U.S. at 831-32.

Finally, and most important, the relationship between the take-or-pay issue and the Commission's elimination of vintage pricing is not at all "inextricable." Assigning the two issues to different proceedings will not lead to inconsistent results. And the two issues are no less severable than most other important issues within the Commission's natural gas jurisdiction. Any requirement that the Commission fully resolve the take-or-pay question as a condition of Order 451's validity is a plain and unwarranted interference with the Commission's authority to control its own docket, and must be set aside.[28]

This feature of the GFN process has already relieved pipelines' take-or-pay obligations in 33% of the contracts renegotiated under Order No. 451. *Natural Gas Policy Act: Hearings on H.R. 1595 Before the Subcomm. on Energy and Power of the House Comm. on Energy and Commerce*, 101st Cong., 1st Sess. 158-59 (April 5, 1989); see also J.A. 121 (detailing dramatic reductions in take-or-pay liabilities in specific settlements).

[28] In the court of appeals, respondents also challenged certain mandatory transportation provisions in Order 451 on the ground that they improperly imposed "common carrier" obligations on the

CONCLUSION

The judgment of the court of appeals should be reversed.

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pipelines. Pet. App. 33a-36a. The panel majority agreed, although it noted that the issue had diminishing practical signficance. Pet. App. 33a & n.34. By its terms, Order No. 451's transportation requirements apply *only* if the pipeline has not already filed for an open access certificate under Order No. 436. *E.g.*, J.A. 45, 177-78. All of the pipelines that were petitioners below have now sought and been granted open access certificates, thereby mooting this issue. See *United States* v. *Munsingwear, Inc.*, 340 U.S. 36, 39 (1950).

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Nos. 89-1452 and 89-1453

In the Supreme Court of the United States

OCTOBER TERM, 1990

MOBIL OIL EXPLORATION & PRODUCING SOUTHEAST, INC., ET AL., PETITIONERS

v.

UNITED DISTRIBUTION COMPANIES, ET AL.

FEDERAL ENERGY REGULATORY COMMISSION, PETITIONER

v.

UNITED DISTRIBUTION COMPANIES, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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QUESTION PRESENTED

Whether Orders No. 451 and No. 451-A of the Federal Energy Regulatory Commission, by creating a new pricing structure for old gas and in effect deregulating all prices, abandonments, and sales of such gas, violate the Natural Gas Policy Act of 1978 and the provisions of the Natural Gas Act of 1938 that remain applicable to the regulation of old gas.

PARTIES TO THE PROCEEDINGS

The parties to these consolidated cases are listed in appendices to the petitions for a writ of certiorari (89-1452 Pet. App. 76a-82a; 89-1453 Pet. App. 83a-86a) and in an appendix to respondents' brief in opposition (App. 1a-11a).

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BRIEF FOR THE RESPONDENTS

STATUTORY PROVISIONS INVOLVED

The full text of Title I, subtitle A, of the Natural Gas Policy Act of 1978 ("Wellhead Pricing Controls"), which consists of Sections 101 through 110 of the statute, 15 U.S.C. §§ 3311-3320, as well as Sections 121, 503, and 601 of the Act, 15 U.S.C. §§ 3331, 3413, and 3431, are reproduced in Appendix A. Also reproduced in Appendix A is the text of Sections 4 and 7(c) of the Natural Gas Act of 1938, as amended, 15 U.S.C. § 717c and § 717f(c). Sections 5(a) and 7(b) of the Natural Gas Act, 15

U.S.C. § 717d(a) and 717f(b), appear in the appendix to the brief of the Federal Energy Regulatory Commission, at 1a-2a.

STATEMENT OF THE CASE

This case involves a challenge to two rulemaking orders issued by the Federal Energy Regulatory Commission ("Commission" or "FERC"), Order No. 451 (J.A. 5-205) and, on rehearing, Order No. 451-A (J.A. 206-436). These orders dramatically increase (by almost 700 percent in some instances) the ceiling prices for 15 categories, or "vintages," of "old" gas regulated under Sections 104 and 106 of the Natural Gas Policy Act ("NGPA").[1] (A table showing the enormous dollar and percentage increases in ceiling prices authorized by Order No. 451 is attached as Appendix B.) The orders also announce the Commission's decision to discontinue altogether its traditional regulation of the commencement and abandonment of old gas service under the Natural Gas Act ("NGA"), and instead to grant blanket authorizations in advance for any future abandonments and sales of old gas.

To place the current controversy in perspective and to describe the extent to which the NGPA changed the Commission's responsibilities and discretion for regulating the natural gas industry, a brief survey of the history of natural gas regulation under the NGA and NGPA is required.

A. The Natural Gas Act

Congress first exercised authority over the natural gas industry in 1938, with the passage of the NGA. *See* 15

[1] "Old" gas is natural gas that was committed or dedicated to the interstate market, and regulated under the Natural Gas Act, when Congress enacted the NGPA in 1978. By definition, old gas does not include gas flowing from newly drilled wells. Old gas is produced from wells drilled before the NGPA, in some instances forty or fifty years ago. As a rule, the production costs for old gas are considerably lower than the costs incurred in producing gas from newer wells.

U.S.C. §§ 717-717w. Through the NGA, Congress imposed comprehensive federal regulation over wholesale sales and transportation of natural gas in interstate commerce. *FPC v. Louisiana Power & Light Co.*, 406 U.S. 621 (1972). The statute's goal, as often recognized by the Court, was to afford consumers "a complete, permanent and effective bond of protection from excessive rates and charges" and to "assure the public a reliable supply of gas at reasonable prices . . . ." *Atlantic Refining Co. v. Public Service Commission*, 360 U.S. 378, 388 (1959); *United Gas Pipe Line Co. v. McCombs*, 442 U.S. 529, 536 (1979); *accord*, *California v. Southland Royalty Co.*, 436 U.S. 519, 523 (1978).

Through the NGA, Congress delegated to the Federal Power Commission (FERC's predecessor agency) broad federal authority over the commencement and abandonment of interstate natural gas sales and transportation services. *See* 15 U.S.C. § 717f(b) and (c). Congress also delegated to the Commission exclusive "'utility-type ratemaking' control over prices and supplies" of interstate natural gas. *Transcontinental Gas Pipe Line Corp. v. State Oil & Gas Board*, 474 U.S. 409, 420 (1986) (hereafter "*Transco*"). This latter authority is contained in Sections 4 and 5 of the NGA, which provide that all rates "shall be just and reasonable . . . ." 15 U.S.C. §§ 717c(a) and 717d.

Under Sections 4(c) and (d) of the NGA, natural gas companies, such as producers selling old gas in interstate commerce, must file any rates or changes in rates and any contracts relating thereto with the Commission. Any such rates, rate changes, or contracts must be kept open for public inspection. 15 U.S.C. § 717c(c) and (d). The Commission is empowered, either in response to a complaint or on its own initiative, to conduct a public hearing on the justness and reasonableness of any rate or rate change. 15 U.S.C. § 717c(e); *see also* 15 U.S.C. § 717d. If the Commission finds, after such a hearing, that any rate is "unjust, unreasonable, unduly discriminatory, or preferential," the Commission must "deter-

mine the just and reasonable rate" and "fix the same by order . . . ." 15 U.S.C. § 717d(a).

Soon after this Court's decision in *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954), which required the Commission to regulate prices charged at the wellhead for gas dedicated to the interstate market, the Commission sought to relieve itself of the burden of setting prices for each producer individually, and therefore adopted a so-called "area rate" approach to gas pricing. That approach was sustained by this Court in *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968) (hereafter "*Permian Basin*"). Later, the Commission switched to a "national rate" approach, and that too was upheld. *Shell Oil Co. v. FPC*, 520 F.2d 1061, 1073-1074 (5th Cir. 1975), *cert. denied*. 426 U.S. 941 (1976). As a key component of both area and national ratemaking, the Commission required some form of "vintaging" of natural gas. Under vintaging, producers receive lower prices for gas already flowing (*i.e.*, "old" gas) and higher prices for new gas, *i.e.*, gas produced from newly drilled wells. Vintage pricing is based on the assumption that, for old gas, "price could not serve as an incentive, and . . . any price above average historical costs, plus an appropriate return, would merely confer windfalls." *Permian Basin*, 390 U.S. at 797.

In December 1974, after the Commission had been using vintaging for more than a decade, the Commission decided to eliminate the practice gradually, as existing contracts for the sale of natural gas in interstate commerce expired. *See Shell Oil Co. v. FPC*, *supra*, 520 F.2d at 1077-1078. The Commission took this step as a way of attempting to address emerging shortages of supply dedicated to the interstate market. The experiment was quickly abandoned, however, and the practice restored, even though supply shortages to the interstate market had become more acute. Vintaging was essential, the Commission said, "to preclude exaction of excessive and unjustifiable economic rent from flowing gas." Opin-

ion No. 770, *National Rates for Natural Gas*, 56 F.P.C. 509, 521 (1976), and Opinion No. 770-A, issued on rehearing, *National Rates for Jurisdictional Sales of Natural Gas*, 56 F.P.C. 2698, 2780 (1976) ("In light of the demonstrable cost differentials associated with various vintages of gas and the impact on the public of permitting the price of all gas to eventually rise to a uniform national rate based on most recent costs . . ., we cannot continue our former policy of eliminating vintaging"), *aff'd*, *American Public Gas Association v. FPC*, 567 F.2d 1016, 1033 (D.C. Cir. 1977), *cert. denied*, 435 U.S. 907 (1978).

By the time Congress enacted the NGPA, the Commission had fully returned to its vintaging policy as an indispensable means of protecting consumers by prohibiting economic windfalls to producers of old gas, and that policy was incorporated into the NGPA itself. *See* Sections 104(a) and (b), 15 U.S.C. §§ 3314(a) and (b). Never until Order No. 451 did the Commission authorize the complete and immediate elimination of all price vintaging of old natural gas.

B. The Natural Gas Policy Act of 1978

Rate regulation under the NGA applied only to the interstate market. By the 1970's, gas producers could obtain significantly higher prices in the unregulated intrastate markets, and shortages therefore developed in the interstate market. In response to this situation, Congress enacted the NGPA, which "has been justly described as a 'comprehensive statute to govern future natural gas regulation.'" *Public Service Commission v. Mid-Louisiana Gas Co.*, 463 U.S. 319, 332 (1983) (hereafter "*Mid-Louisiana*"), quoting Note, *Legislative History of the Natural Gas Policy Act*, 59 Texas L. Rev. 101, 116 (1980); *see also Transco*, 474 U.S. at 420. The NGPA was the product of two conflicting legislative approaches. In the Court's words, "the Senate passed a bill deregulating interstate gas, the House passed a bill extending federal regulation to intrastate gas, [and t]he Conference Committee struck a compromise." *FERC* v. *Martin Ex-*

ploration Management Co., 486 U.S. 204, 207 (1988) (citations omitted) (hereafter "*Martin Exploration*").

At the heart of the compromise was "an exhaustive categorization of natural gas production." *Mid-Louisiana*, 463 U.S. at 332. In extensive and intricate detail, Congress established several categories and subcategories of old gas (Sections 104 and 106), new gas (Sections 102 and 103), gas sold under existing intrastate contracts (Section 105), and difficult-to-produce gas (Sections 107 ("high-cost" gas) and 108 ("stripper well" gas)). In addition, to avoid any gaps in coverage, Congress created, in Section 109, a catch-all category covering "any natural gas which is not covered by any maximum lawful price under any other section" of the statute. *Id.* at 332-333.

Congress then assigned specific price ceilings to all of the categories of gas identified in the statute, and it also provided for automatic increases in these ceilings to keep pace with inflation. Congress assigned the highest price ceilings to difficult-to-produce gas and the next highest ceilings to new gas. These ceilings were considerably higher than any of the "just and reasonable" rates that the Commission had previously established under the NGA. Congress assigned the lowest ceilings to old gas; it simply enacted into law, for each vintage of old gas, the rates previously set by the Commission under the NGA, adjusted for inflation. *See Energy Reserves Group, Inc. v. Kansas Power & Light Co.*, 459 U.S. 400, 417 n.24 (1983) ("Old interstate gas is subject to the much lower ceilings of § 104, or § 106"). The NGPA thus "directly incorporates part of the 'vintaging' pattern that previously existed under the NGA." *Mid-Louisiana*, 463 U.S. at 334.[2]

Congress had a clear purpose in prescribing a "tiered" approach to the pricing of old, new, and difficult-to-produce

[2] For the catch-all category of natural gas established in Section 109, Congress fixed the initial ceiling price at the same level as the highest ceiling price applicable to an old gas vintage. *See* 15 U.S.C. § 3319(b)(1)(A). This was the ceiling price for the most recent vintage of old gas, gas produced from wells drilled in 1975 through early 1977.

natural gas. It intended to provide incentives for the development of new and difficult-to-produce gas, because that development would increase the Nation's natural gas resource base. For old gas, Congress recognized that such incentives were not necessary, because old gas, by definition, was already available to the market. Congress therefore withheld any additional incentives from old gas, unless it otherwise qualified under an incentive-priced category. *Mid-Louisiana*, 463 U.S. at 334-335, 342.

As the Commission explained in its brief to this Court in the *Mid-Louisiana* case, "no incentive [was] required" for old gas because the gas already "flowed in interstate commerce prior to enactment of the NGPA . . . ." Brief for Federal Energy Regulatory Commission 31 n.33 (Nos. 81-1889 *et al.*). *See also Pennzoil Co. v. FERC*, 645 F.2d 360, 367 (5th Cir. 1981), *cert. denied*, 454 U.S. 1142 (1982) ("the NGPA provided consumer protection by maintaining lower prices on flowing gas"). Indeed, in Order No. 451 itself, the Commission recognized that "Congress considered this provision for old gas prices to be a significant feature of the NGPA's design, intended to mitigate the effects on consumers of allowing higher prices for new gas." J.A. 219.

In addition to the incentives provided in the NGPA for new gas and various explicitly identified categories of difficult-to-produce gas, Congress also authorized the Commission to establish special incentives for *any* natural gas produced under conditions that the Commission "determines to present extraordinary risks or costs." *See* Sections 107(b) and (c)(5), 15 U.S.C. §§ 3317(b) and (c)(5). Congress allowed such special incentives only to the extent "necessary" to stimulate production.

The only other NGPA provisions allowing the Commission to establish price ceilings different from those prescribed by Congress were Sections 104(b)(2), 106(c), and 109(b)(2). The provisions applied only to old gas and to the NGPA's catch-all category of gas that did not fit under any of the other statutory classifications. These

withhold new production incentives. Congress limited the were the very categories for which Congress decided to price ceiling increases permissible under these provisions to those shown to be "just and reasonable within the meaning of the Natural Gas Act." [3]

As the final part of the legislative compromise reflected in the NGPA, Congress specifically delineated those categories of gas that were to be deregulated at specified times in the future, through the elimination of price ceilings. The relevant NGPA provision is Section 121, 15 U.S.C. § 3331. It demonstrates that when Congress wanted to deregulate certain categories of natural gas, it did so directly. Under Section 121, "the price ceilings for certain 'high-cost' gas were eliminated in 1979, for certain 'old' intrastate gas and 'new' gas in 1985, and for certain other 'new' gas in 1987." *Martin Exploration*, 486 U.S. at 207. Old interstate gas (*i.e.*, the kind of gas that is subject to the price ceilings of Section 104 and 106) is *not* included among the categories of gas that Congress chose to deregulate.

C. The Commission's Prior Interpretations of the NGPA

Before its adoption of the Orders at issue in this case, the Commission had several opportunities to interpret and apply the NGPA and to construe Sections 104(b)(2) and 106(c). Much of what the Commission said and did at the time of the NGPA's enactment and in the years immediately thereafter demonstrates that the Commission believed: (i) that Congress chose in the NGPA not to provide new incentives for the production of old gas; and (ii) that the rate-setting provisions in Sections

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[3] For old gas, "just and reasonable" prices under the NGA primarily reflected prices based on actual costs, using test year data, with some allowance for future exploration costs. *See, e.g.*, Opinion No. 749, *Just and Reasonable National Rates for Sales of Natural Gas*, 54 FPC 3090 (1975), *aff'd Tenneco Oil Co. v. FERC*, 571 F.2d 834, 840 (5th Cir.), *cert. dismissed*, 439 U.S. 801 (1978) ("The 'zone of reasonableness' is wide. The producers, under the Constitution as well as the [NGA], are, at bottom, only entitled to a fair return on their actual costs").

104(b)(2) and 106(c) were limited "special relief" provisions, which were not intended to empower the Commission to adopt across-the-board, incentive price ceilings for old gas.

1. *The Curtis/Jackson letter and the accompanying FERC analysis of the NGPA*

As congressional consideration of the NGPA was drawing to a close, several members of the Senate Committee on Energy and Natural Resources requested that the Chairman of the Commission prepare an analysis of the final conference committee report, and comment on the proposed legislation. Chairman Curtis responded in a letter to Senator Jackson, the Chairman of the Senate Committee. With the letter, Chairman Curtis submitted the Commission's analysis of the conference bill. *See* Letter of Charles B. Curtis, FERC Chairman, to Senator Henry M. Jackson (Sept. 8, 1978), relevant portions reproduced in *Natural Gas Policy Act Information Service*, Vol. 1, ¶¶ 21-25, Federal Programs Advisory Service (1980).

At the outset, the Commission observed that the NGPA is "unusually detailed," and that this detail "gives greater definition of Congressional intent than is generally the case . . . ." *Id.* ¶ 22, at 1. The Commission further stated (*id.*) that this greater level of detail created

> advantages of regulatory certainty which are derived from a full and detailed exposition of the requirements of the law rather than leaving such matters to implementing regulations of an administrative agency acting under a broad grant of delegated authority.

With respect to the authority conferred by Sections 104(b)(2) and 106(c) of the NGPA, the Commission's comments plainly contemplated that that authority would be exercised in response to applications from individual producers for relief from the statutory price ceilings, not as a means of drastically revising the overall pricing structure established by Congress (*id.* at 4-5):

Except in instances where the Commission receives applications for rates in excess of the maximum lawful prices under the NGPA (in which case it may establish a higher rate if it meets just and reasonable standards), the Commission will no longer inquire into producer costs nor establish permissible rates of return. Instead, the focus of the inquiry will be on whether geological information, production histories, field records, prior contractual agreements, and the like, evidence eligibility for the statutory rates permitted for different classifications of production.

2. *The Commission's Order No. 23: The interaction of the NGPA and contractual price escalator clauses*

In Order No. 23, issued less than five months after the NGPA became law, the Commission considered the applicability of contractual price escalator clauses to the new price ceilings set by the statute. 44 Fed. Reg. 16,895 (Mar. 20, 1979). A typical price escalator clause provides "that if a governmental authority fixes a price for any natural gas that is higher than the price specified in the contract, the contract price shall be increased to that level." *Energy Reserves Group, Inc. v. Kansas Power & Light Co., supra,* 459 U.S. at 403. As the Commission acknowledged in Order No. 451-A, a very substantial majority (approximately 90 percent) of all contracts for the sale of old gas contain such clauses. J.A. 310.

The question addressed in Order No. 23 was whether price escalator clauses should be construed to permit the immediate collection of the new ceiling prices set by the NGPA. The Commission concluded that it would not interpose any general objection to such escalations, and its position was sustained in *Pennzoil Co. v. FERC*, 645 F.2d 360 (1981), *cert. denied*, 454 U.S. 1142 (1982).

The Commission remarked that permitting price escalator clauses to be triggered by the NGPA price ceilings was "particularly appropriate" in the context of the old gas ceiling prices established under Sections 104 and 106(a) of the NGPA. This was because, unlike the incentive ceiling prices established in the NGPA for new

and difficult-to-produce gas, the old gas ceilings were "based [on] and inextricably linked to previously prescribed FPC rates"—rates that had already been collected under the NGA, often pursuant to the very escalator clauses that the Commission considered in Order No. 23. 44 Fed. Reg. at 16,903.

In the course of its discussion in Order No. 23, the Commission, speaking in the specific context of old gas pricing, explicitly recognized that the NGPA imposed limits on the Commission's prerogatives:

> The system of legislating prescribed maximum ceiling prices replaces in large measure both the Commission's authority and its responsibility to establish just and reasonable rates applicable to producer sales in interstate commerce.

44 Fed. Reg. at 16,897. The Commission further explained that "[w]hat the Congress did in enacting Section 104 was to freeze as of April 20, 1977 the presently lawful FPC rates and to change the escalation factors from those established by the FPC to a different method required by the Congress." *Id.* at 16,903.

3. *The Commission's proposed rulemaking under Section 104 and Section 106: Procedures governing applications for special relief*

Less than a year after the NGPA was passed, the Commission turned its attention specifically to the Commission's authority under Sections 104(b)(2) and 106(c) to increase ceiling prices for old gas. *Procedures Governing Applications for Special Relief Under Sections 104, 106 and 109 of the Natural Gas Policy Act*, Notice of Proposed Rulemaking, 44 Fed. Reg. 49,468 (Aug. 23, 1979). As the title of the Commission's notice suggests, the Commission interpreted its authority under Sections 104(b)(2) and 106(c) to apply to particular situations in which the existing ceiling price was "too *low*" to enable a particular producer to recover its costs. *See Mid-Louisiana*, 463 U.S. at 333 (emphasis in original).

Neither in its original notice of rulemaking, nor in its two subsequent requests for further comments, nor in its eventual termination of the rulemaking proceeding did the Commission suggest that its authority under Sections 104(b)(2) and 106(c) could be used to create new incentive prices for *all* flowing old gas or to restructure the pricing policies of the NGPA. *See* 45 Fed. Reg. 5,321 (Jan. 23, 1980); 45 Fed. Reg. 31,744 (May 14, 1980); 49 Fed. Reg. 21,910 (May 23, 1984). Rather, the Commission proceeded on the assumption that special relief rates under Sections 104 and 106 must not be so high as to create a windfall for producers. *See* 45 Fed. Reg. at 5,323 (citing *Public Service Commission v. FERC*, 589 F.2d 542 (D.C. Cir. 1978)). And the Commission made it clear that, if a producer of old gas desired an incentive price, it would have to proceed under some section of the NGPA other than Sections 104(b)(2) or 106(c). *Id.* at 5,321.

The proposed regulations were withdrawn and the rulemaking proceedings terminated in 1984, when the Commission concluded that it would implement its authority under Sections 104 and 106 on a case-by-case basis. *See* 49 Fed. Reg. 21,910 (May 23, 1984). The Commission determined that the existing gas surplus, combined with producers' ability to obtain higher ceiling prices under *other* sections of the NGPA, removed the need for industry-wide standards for "special relief."

In withdrawing the proposed regulations, the Commission gave a clear indication of its understanding of the scope of its authority under Sections 104(b)(2) and 106(c). The Commission explained that "[w]hen Congress enacted the NGPA in 1978, it provided a link between the NGA's special relief procedures and the NGPA in sections 104(b)(2), 106(c), and 109(b)(2)." 49 Fed. Reg. at 21,910. The Commission further explained that "[u]nder the NGA, special relief was a 'safety valve' for area or national rates that might otherwise have been confiscatory." *Id.* at 21,912; *see also Permian Basin*, 390 U.S. at 770-774. While the Commission said that it

"will continue to use special relief as a 'safety valve' in those situations where the maximum lawful price under Sections 104 or 106(a) does not allow a producer to recoup costs," it concluded that it should not use this statutory authority to grant the same kind of incentive prices that were available elsewhere.[4]

4. *The Commission's Order No. 72 and the producers' proposal to circumvent Sections 104 and 106*

Shortly after the NGPA was enacted, producers of old gas (including many of the producers that are petitioners here) proposed a plan that would have permitted them to apply to all vintages of old gas the ceiling price for the most recent vintage. As explained above, this was the highest ceiling for any of the vintages and the same ceiling that the Commission later adopted for all old gas in Order No. 451.

The producers' proposal was simply to drill new wells in fields that were already producing old gas. Their theory was that new wells placed right alongside wells producing old gas would not fit within any of the existing vintages, and therefore would fall within the catch-all category of Section 109. This, the producers said, would entitle them to the Section 109 ceiling, which, as mentioned above (*see* note 2, *supra*), was equal to the ceiling for the most recent vintage of old gas. Through the expedient of drilling unnecessary new wells to pro-

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[4] In its case-by-case review of special relief applications under Sections 104(b)(2) and 106(c), the Commission required a producer to carry the burden of demonstrating that the existing vintaged ceiling price had become confiscatory in the producer's individual circumstances. *See, e.g., Phillips Petroleum Co.*, 32 F.E.R.C. ¶ 61,463, at 62,060 (1985) ("Special relief is justified only in exceptional or extraordinary cases in which the producer demonstrates that its existing rates do not permit recoupment of costs"); *A.O. Phillips Estate*, 27 F.E.R.C. ¶ 61,377, at 61,728 (1984) ("special relief was to act as a 'safety valve' for producers for whom gas sales at the applicable area rates might amount to an unconstitutional taking of private property without due process"). The Commission seldom found special relief to be justified under this standard.

duce the very gas already being produced by existing wells, the producers hoped to escape the price restraints of Sections 104 and 106.

The Commission rejected the producers' stratagem, calling it "a regulatory alchemy." Order No. 72, 45 Fed. Reg. 18,915, 18,917 (Mar. 24, 1980). The Commission reasoned that "[u]nquestionably, a fundamental purpose of the incentive prices of Title I of NGPA was to encourage investment in the exploration and development of *new* natural gas reserves." *Id.* (emphasis added). Congress did not intend, however, "to induce capital investment and the use of limited resources for the production of supplies of natural gas which are already available." *Id.*

Moreover, the Commission continued, the attempt to circumvent the price limitations on old gas simply by drilling new wells could nullify Sections 104 and 106 entirely. "A reading of section 109 which has the potential to make sections 104, 105 and 106 inapplicable to flowing natural gas is neither reasonable nor consistent with the pricing scheme of the NGPA." *Id.* at 18,918. The Fifth Circuit affirmed this interpretation. *See ECEE, Inc. v. FERC*, 645 F.2d 339, 357-360 (5th Cir. 1981).

Thus, in Order No. 72, the Commission rejected a ceiling price for old gas, equal to that established in Order No. 451, as being contrary to the "pricing scheme of the NGPA." And the Commission also acknowledged that Congress did not intend to provide additional production incentives for old gas, which is precisely what the Commission would later allow in Order No. 451.

5. *The Commission's Orders No. 107 and No. 107-A: The applicability of Section 107(c)(5) price incentives to old gas*

The Commission has twice considered the question whether it should authorize an incentive price under Section 107(c)(5) for the production of old gas through the use of production enhancement techniques. Section 107(c)(5) empowers the Commission to provide an incentive

for production that presents "extraordinary risks or costs." Initially, the Commission concluded that old gas covered by Sections 104 and 106 should not be eligible for such incentive prices at all. *High-Cost Natural Gas: Production Enhancement Procedures*, Order No. 107, 45 Fed. Reg. 77,421 (Nov. 24, 1980). The Commission explained that "Congress has provided special repricing mechanisms" for old gas in Sections 104(b)(2) and 106(c), and that the Commission had begun a rulemaking proceeding to establish "substantive and procedural guidelines for granting 'special relief'" under these sections. *Id.* at 77,422 nn.8, 11.

Three years later, on rehearing, the Commission reversed its position and granted a "production enhancement incentive price" under Section 107(c)(5) to old gas, if it could qualify for that price under the Commission's production enhancement rule. Order No. 107-A, 48 Fed. Reg. 45,097 (Oct. 3, 1983).[5] The Commission stressed that "not all production enhancement work on interstate wells involves extraordinary costs or requires incentive prices for production." *Id.* at 45,100. The production enhancement rule therefore prescribed very specific "substantive qualification standards and procedural safeguards" to ensure that the incentive price would be granted *only* to "that gas for which it is 'necessary' to provide a 'reasonable' incentive." *Id.*[6]

[5] As this Court stated in *Mid-Louisiana*, 463 U.S. at 335, "old gas that would be subject to the old NGA vintaging rules may be entitled to a higher rate if it falls within one or more of the other Title I categories, in particular § 107 (high-cost natural gas) and § 108 (stripper well gas)."

[6] Among other things, the rule required that producers seeking a Section 107(c)(5) incentive price identify *in advance* the specific production enhancement work they proposed to perform and that they then *actually perform* that work once the incentive price was granted.

Even with this requirement that the producer *actually incur* the costs associated with the additional work, the rule limited the incentive price available under Section 107(c)(5) to the Section 109 ceiling price. That is, the *maximum* incentive available under Sec-

The detailed and demanding limitations that the Commission imposed in its production enhancement rule are noteworthy because the Commission there was exercising its authority under Section 107, a provision undisputedly designed to provide incentive prices. Even so, the Commission took pains to avoid granting any across-the-board incentives, and to confine incentive prices only to "reasonable" levels and only to those situations where such prices were "necessary" for a particular producer and particular well. Section 107(b), 15 U.S.C. 3317(b).

The Commission expressly distinguished the "special relief" authorized by Sections 104(b)(2) and 106(c) from the incentive prices authorized by Section 107:

> [S]pecial relief procedures serve a different function than the incentive pricing program. Special relief procedures as they have been traditionally interpreted are intended to provide economic relief after the fact, that is, after the producer undertook to develop and produce gas . . . . [T]he section 107 incentive price was intended to provide an incentive *in advance* of drilling activity to encourage production where it may not have been economically feasible.

48 Fed. Reg. at 45,101 (emphasis in original).[7]

tion 107 for old gas that qualified under the production enhancement rule was the same as the ceiling later adopted for all old gas in Order No. 451.

The rule also provided a separate formula to guarantee that under no circumstances would the Section 107(c)(5) incentive permit the price of incremental gas production to rise above twice the ceiling price for new gas under Section 103. *See* 18 C.F.R. § 271.704(c)(1)(B)(2)(v).

In addition, the rule required (i) that the producer submit its own sworn affidavit and an affidavit from its pipeline purchaser stating that the incentive price was necessary to enhance production of old gas; and (ii) that the appropriate jurisdictional agency find "that there is a reasonable basis to conclude that the price is necessary as a reasonable incentive and that the production enhancement would not be performed but for the price." 48 Fed. Reg. at 45,100.

[7] Without citation, the Commission asserted in a footnote that its authority under Sections 104(b)(2) and 106(c) may extend

6. *The Commission's block billing proposal*

Several months before the Commission initiated the rulemaking proceedings that led to Order No. 451, it proposed, and requested public comment on, a new pipeline rate design mechanism that it called the "block billing" rule. *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, Notice of Proposed Rulemaking, 50 Fed. Reg. 24,130 (June 7, 1985).

As proposed, the block billing rule would require interstate pipelines to segregate their "old" and "new" natural gas supplies into two blocks, thereby ending the standard pipeline practice of "rolling in" or "averaging" the costs of all gas supplies purchased by the pipeline. After such "blocking," traditional pipeline customers, *i.e.*, local distribution companies that serve residential, commercial, and industrial consumers, would be authorized to purchase the pipeline's "block 1" old gas. Non-traditional pipeline customers, such as large industrial end users, would be authorized to purchase the pipeline's "block 2" new gas.

The stated objective of the block billing rule was to provide clearer pricing signals so that customers would not be misled by average prices that included both new gas and lower-priced old gas. 50 Fed. Reg. at 24,139. In explaining its initial proposal, the Commission recognized that the "vintaged" price of old gas was below the market price, and it stressed that the savings associated with the purchase of this gas (which the Commission called "economic rents") were to be "preserved for" and made available to consumers and other traditional pipeline customers, *"as Congress apparently intended."* *Id.* at 24,138 (emphasis added).

"much further" than the special relief proposals then under consideration in the rulemaking described at pages 11-13, *supra*. 48 Fed. Reg. at 45,101 n.14. But the Commission never suggested that Sections 104(b)(2) and 106(c) could be used to provide new incentive prices for old gas, much less across-the-board new incentives that would completely revise the pricing structure of the NGPA.

Thereafter, approximately two months before the Commission initiated the Order No. 451 rulemaking, it requested supplemental comments on its block billing proposal. Notice Requesting Supplemental Comments, 50 Fed. Reg. 42,372 (Oct. 18, 1985). In this Notice, the Commission left no doubt about its interpretation of the role that Congress intended old gas to play in the natural gas market. The Commission said:

> [B]lock 1 gas [*i.e.*, old gas] is *not market responsive specifically by legislative intent*. Thus, . . . the categories of gas in block 1 should not be allowed to distort marginal decisions by consumers and producers. Block 2 [*i.e.*, new gas], by contrast, is gas whose price has been decontrolled or which is subject to NGPA regulation that intended prices to be market responsive.

Id. at 42,376 (emphasis added). Thus, on the eve of the appearance of Order No. 451, the Commission itself expressly admitted that under the NGPA old gas was not intended to be "market responsive." [8]

D. The Immediate Background of Order No. 451

Although the NGPA succeeded in encouraging the development of new gas supplies and in reducing the disparity between the interstate and intrastate markets, other problems soon arose. Natural gas prices remained high, largely because many purchasers, in response to earlier gas shortages, entered into high-price "take-or-pay" contracts that guaranteed a specified volume of gas but obligated the purchaser to pay for that volume at the contract price, even if the purchaser could not take the gas. *See* Pet. App. 29a; *Transco*, 474 U.S. at 412. At the same time, projected demand did not materialize

[8] In Order No. 451, the Commission stated that "the block billing and [Order No. 451] proposals are to a large extent mutually exclusive and . . . it is questionable whether they could be combined or if so what the likely consequences would be." J.A. 169-170. Nevertheless, the Commission decided not to terminate its block billing proposal, but to "review the matter in light of the operation of [Order No. 451] in actual practice . . . ." *Id.* at 170. The block billing rule is still pending before the Commission.

due to a sharp decline in the price of oil and other competing fuels, an economic recession, improved energy conservation, and other causes. These factors led to an imbalance between the available supply and market demand for natural gas, which in turn reduced incentives for exploration and new development. *See* Pet. App. 8a-9a; J.A. 33-34; *Maryland People's Counsel v. FERC*, 761 F.2d 768, 770-771 (D.C. Cir. 1985).

Throughout this period, the Commission and the Department of Energy ("DOE") grew increasingly dissatisfied with the congressional pricing policies embodied in the NGPA. In 1981, for example, the Chairman of the Commission testified before a Senate Committee that "the most serious deficiency" of the NGPA was the "establishment of a new *dual market*, that is, one in which some gas prices are regulated while others are not." J.A. 35 n.59 (emphasis in original). In 1982, the Commission issued a Notice of Inquiry proposing to increase old gas prices, but abandoned the effort because of congressional opposition. Pet. App. 9a-10a. Then, in July 1984 and January 1985, DOE filed with Congress two reports on the natural gas market, as required by Section 123 of NGPA, 15 U.S.C. § 3333.[9] DOE urged Congress to remove price controls on old gas, and comprehensively to deregulate wellhead gas sales. Congress took no action in response to DOE's requests.

Having failed to convince Congress that the NGPA's pricing structure should be changed, the Commission, in response to a rulemaking proposal formulated by DOE, decided to act on its own.

E. Orders No. 451 and No. 451-A

1. *Deregulation of old gas prices*

In issuing Orders No. 451 and No. 451-A, the Commission essentially deregulated old gas prices. The Com-

[9] *See The First Report Required by Section 123 of the Natural Gas Policy Act of 1978* (July 1984); "Increasing Competition in the Natural Gas Market," *The Second Report Required by Section 123 of the Natural Gas Policy Act of 1978* (January 1985).

mission intended for those prices to be set by the market and no longer to be controlled or affected by the NGPA ceilings. The Commission itself admitted as much. The "fundamental purpose of the rule," the Commission said, "is to assure that old gas prices will more accurately reflect market clearing prices . . . ." J.A. 285.

To achieve this goal, the Commission first collapsed all of the ceiling prices applicable to the different vintages of flowing old gas that Congress preserved in Sections 104 and 106 of the NGPA into a single new vintage. J.A. 42-45. It then decreed that the new ceiling price for all old gas would be the *highest* ceiling price then in effect for any of the old gas vintages under Section 104. *Id.* at 42-45, 233.

This price, which was the ceiling price for the *newest* vintage of old gas, had been established initially by the Commission, prior to the NGPA, as a "new gas" price for wells drilled after 1974. *See* Opinion No. 770, *National Rates for Natural Gas*, 56 F.P.C. 509 (1976). The price was based on replacement costs, not historical costs, and thus was intended to be an incentive rate for the exploration and development of new gas reserves.

In recognition of this fact, Congress, in the NGPA, adopted the highest old gas ceiling price as the ceiling price for the catch-all category created by Section 109, and the Commission adopted the same ceiling as the maximum incentive price that would be allowed for qualified production enhancement gas produced under conditions of extraordinary risk or cost under Section 107(c)(5). By adopting this same ceiling in Order No. 451, the Commission in a single stroke gave *all old gas* the same incentive price that had previously been available *only* in exceptional cases, after compliance with the stringent requirements of the Commission's production enhancement rule.

The Commission attempted to justify the enormous increase in the old gas ceilings by claiming that higher prices were necessary to give producers an incentive not to abandon old gas wells prematurely. J.A. 24, 54, 95-96.

The Commission reached this conclusion even though the orders did not identify a single producer who had abandoned or was about to abandon old gas production because of the vintage pricing system, and even though, under Section 7(b) of the NGA, no producer was permitted to abandon an old gas well without the Commission's express prior approval. The Commission itself predicted that the majority of abandonment decisions would not even be made until after 1990. J.A. 260.

The Commission also failed to explain why higher prices for *all* flowing gas and the consequent wholesale revision of the NGPA pricing structure were necessary to achieve its goal. As numerous parties before the Commission observed, regulations and procedures already in effect would have allowed the Commission to induce additional old gas production at much less cost to consumers. In short, the Commission could have stimulated old gas production and at the same time protected consumers by "targeting" increased prices only to those old gas wells that producers otherwise might have sought to abandon prematurely. *See* Pet. App. 16a n.21. The Commission did not respond to the comments that made this point.

Moreover, notwithstanding its decision to authorize producers to receive higher prices for old gas, the Commission set no conditions of eligibility, as it had done in its Section 107(c)(5) rulemaking, to ensure that the producers' economic gains would actually lead to increased production. Instead, the Commission simply made the new incentive available to *all* old gas, regardless of whether *any* additional gas would be produced and regardless of whether any production enhancement work would be performed.

Because approximately 90 percent of old gas was sold under contracts containing escalator clauses (J.A. 310), most producers would have been entitled immediately to collect any new rate that the Commission determined was just and reasonable. This is what happened routinely as a result of the Commission's NGA ratemaking before the NGPA was enacted, and it is what continued to happen

routinely under the NGPA as the old gas price ceilings adopted by Congress were increased monthly by the statutory inflation adjustment factor. The applicable price ceilings were regularly collected.

The new Order No. 451 price ceiling, however, was different. The Commission said that actual collection of the new price would cause "the ceiling price [to] become a floor and that would distort the market as much as current artificially low ceiling prices." J.A. 141. *See also id.* at 310 (automatic collection of the ceiling price "would not be a just and reasonable result in the sense of providing for the lowest reasonable rate under MGA [*sic*] Section 5(a)"); *id.* at 141 (producers with escalator clauses "should not automatically receive the new ceiling price").

This was an astonishing concession. Although the Commission repeatedly declared that the new ceiling was just and reasonable (*see, e.g.*, J.A. 95), it simultaneously ruled that it would be *unjust* and *unreasonable* if natural gas producers were actually to receive the new ceiling price, as they ordinarily would have, through the operation of price escalator clauses. J.A. 141, 311 n.174. By its own admission, therefore, the Commission failed to set a price the collection of which would be just and reasonable.

The Commission attempted to correct this fundamental flaw by engrafting onto its new pricing scheme the so-called "good faith negotiation" ("GFN") procedure. The stated purpose of the GFN procedure was to avoid collection of the Commission's new, assertedly "just and reasonable" ceiling price and to allow parties to establish prices for old gas through private negotiations. J.A. 141-142, 310, 311 n.174.

The Commission characterized the GFN procedure as "an integral part of the new ceiling price itself . . . ." J.A. 43-44. As is apparent on the face of the GFN rules, however, and as the court of appeals correctly found (Pet. App. 31a-32a), the so-called "negotiation" procedure is in fact extremely one-sided and has given producers an unfair advantage. The GFN procedure cannot possibly achieve its stated goal of protecting purchasers against the Order No. 451 ceiling price.

To further its new policy of establishing "regulated" rates through private "negotiations," the Commission took additional steps to free producers of old gas from all other statutory requirements applicable to the rate-setting process. For example, under Section 4(b) of the NGA, 15 U.S.C. § 717c(b), a newly negotiated rate for old gas that differs from the previously filed rate cannot become effective unless the producer first submits a filing to the Commission. *See Maislin Industries, U.S. v. Primary Steel*, 110 S. Ct. 2759 (1990); *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571 (1981). In Order No. 451, however, the Commission waived all such rate filing requirements for all old gas that, as a result of the GFN procedure, is sold to new purchasers. J.A. 46, 164. This allows producers to negotiate rates different from the filed rate without submitting those rates to the Commission for its approval and without observing the public notice requirement applicable to new rates. Producers can thus avoid facing any regulatory constraint in collection of the "negotiated" rate. Order No. 451, therefore, put producers of "regulated" old gas in essentially the same shoes as producers of deregulated new gas.

2. *The GFN process—The Commission's removal of all regulation from old gas*

The GFN process essentially consists of three steps. Step One gives the producer the sole right to initiate the process. The producer does so by simply requesting the purchasing pipeline to nominate a new price for old gas that the producer chooses to place into the negotiating process. J.A. 46, 296; 18 C.F.R. § 270.201(b)(1)(i). In Step Two, the pipeline responds to the producer's request. If the pipeline nominates the new, "market-distorting" ceiling price, then the producer must honor its sales contract and continue service. If, on the other hand, the

pipeline nominates the prevailing market price or any price other than the new ceiling price, *or* if the pipeline proposes a change in *any* other term of the contract, the producer possesses the unilateral right to reject the offer, cease "negotiations" and terminate the sale. J.A. 159-160; 18 C.F.R. § 270.201(d).[10]

Finally, in Step Three, the producer is given the unilateral right to terminate, upon 30 days' notice, the old gas contract it brought into the GFN process, in any case where the producer rejects the pipeline's nominated price and the producer has identified a new purchaser for the gas.[11] J.A. 160; 18 C.F.R. § 270.201(e)(3) and (4). As part of this step, the Commission also granted the producer an automatic right to abandon under NGA Section 7(b) the service obligation secured by the terminated contract.[12] J.A. 147-148. The Commission said that it did

[10] In Step Two, the pipeline also may ask the producer to nominate a new price for any gas (new or old) sold under any *other* contract between the parties that contains at least some old gas. J.A. 158; 18 C.F.R. § 270.201(b)(2). If a purchaser requests renegotiation of another gas contract in this way, and the parties fail to reach agreement on a new price, the purchaser may terminate the other contract. J.A. 159-160, 296-297.

[11] The requirement that the producer identify a "new purchaser" before terminating an old gas contract is of little practical significance. The producer may discharge its obligation by reselling the gas to anyone. There is also no requirement under the GFN procedure that the new sale be for any specific length of time. Thus, a producer can terminate its contract with an existing pipeline purchaser, resell the gas for one day to a new customer at any price up to the new ceiling, and thereafter be entirely free from Commission regulation.

[12] The producer's obligation to continue existing service arises from the NGA itself. Under Section 7(c) of the NGA, 15 U.S.C. § 717f(c), no sale or transportation of natural gas subject to the Commission's jurisdiction can occur unless the Commission has first issued a certificate reflecting its determination that the proposed transaction will serve the "public convenience and necessity." Once a certificate of public convenience and necessity has been issued for a particular natural gas service, that service must be continued (even after contractual obligations have expired), unless and until the Commission affirmatively authorizes the abandonment

so to ensure the "market responsive" benefits of the rules. *Id.* at 147. In furtherance of that purpose, the Commission excused producers even from submitting an application for abandonment approval under Section 7(b) of the NGA. *Id.* at 147-148.

As a further means of ensuring the alleged "market responsive" benefits of the GFN procedure, the Commission required all natural gas pipelines, including those that had not already agreed to serve as "open access" pipelines under a special certificate from the Commission, to provide transportation of gas released under the GFN procedure. J.A. 46, 176-181. In addition, the Commission gave producers "blanket" sales certificate authorization under NGA Section 7(c) to resell the released gas. *Id.* at 179-181. The Commission thus determined in advance that *any* sale of old gas that *any* producer wanted to make to *any* new purchaser at *any* price up to and including the new ceiling would inevitably serve the public convenience and necessity. The authorization required by Section 7(c) now exists automatically, with no application by the producer, no actual certificate from the Commission, no examination of specific facts associated with the sale, and no opportunity for protest by interested parties (such as respondents).

Order No. 451 thus worked a comprehensive removal of *all* of the NGA regulatory constraints that Congress specifically preserved for old gas in the NGPA. *See* Section 601 of the NGPA, 15 U.S.C. § 3431. In lieu of regulation, "the Commission relie[d] on market forces to assure that purchasers have adequate supplies at reasonable cost." J.A. 304 n.162.

3. *The Commission's response to problems arising from high-price take-or-pay contracts*

In Order No. 451, the Commission devoted scant attention to the problems caused by the proliferation of high-

of the service under Section 7(b), based on a finding that the standards set forth in that provision have been satisfied. *See* 15 U.S.C. § 717f(b).

price take-or-pay clauses in natural gas contracts. The Commission's principal response was to state that "the free operation of market forces will provide a resolution of this issue." J.A. 68. In developing this "solution", the Commission relied on its action in another rulemaking, Order No. 436, in which the Commission also counted on the "workably competitive" market to resolve the take-or-pay problem. *Id., citing* Order No. 436, 50 Fed. Reg. 42,408 (Oct. 18, 1985), and Order No. 436-A, 50 Fed. Reg. 55,217 (Dec. 23, 1985). *See also* J.A. 119-120, 292-295.[13]

F. The Court of Appeals' Decision

The court of appeals ruled that Orders No. 451 and No. 451-A exceeded the authority conferred on the Commission by Congress and were inconsistent with the NGPA. The court therefore vacated the Orders in their entirety. Pet. App. 1a-36a. Observing that the Commission had collapsed the vintaging system and set a single ceiling price for old gas far above the market rate, the court concluded that the Commission had "ignored congressional intent and exceeded its authority by allowing for de facto deregulation of old gas." *Id.* at 17a.

The court of appeals was

> persuaded that Congress deliberately chose to maintain lower old gas prices in order to "[concentrate] the rewards of higher prices where they are most needed—on the development of new, high cost gas" and to elicit "[t]he maximum supply response at a minimum cost to consumers."

[13] After the issuance of Orders No. 451 and No. 451-A, the D.C. Circuit vacated Order No. 436 in *Associated Gas Distributors v. FERC,* 824 F.2d 981 (D.C. Cir. 1987), *cert. denied,* 485 U.S. 1006 (1988). The court held that the Commission's take-or-pay rationale "reflects questionable legal premises and fails to meet the requirement of 'reasoned decision making.'" *Id.* at 1023. After a series of subsequent rulemaking orders, and two more trips to court, the Commission recently succeeded in obtaining judicial approval of a take-or-pay relief mechanism. See *American Gas Association v. FERC,* No. 87-1588 (D.C. Cir. Aug. 24, 1990). This mechanism, however, expressly excludes gas released under the GFN procedures from qualifying for the prescribed take-or-pay relief.

Pet. App. 20a, *quoting* 124 Cong. Rec. 28,633 (1978) (remarks of Sen. Jackson). The court also relied on the Commission's own recognition that lower old gas prices were "a significant feature of the NGPA's design, intended to mitigate the effects on consumers of allowing higher prices for new gas." J.A. 219, *quoted at* Pet. App. 21a. The court therefore ruled that in Order No. 451 the Commission improperly interpreted the scope of its authority under Sections 104(b)(2) and 106 (c). The court said that the Commission should not be permitted to "jettison" what the Commission itself had characterized as a "significant feature" of the NGPA design. Pet. App. 22a-23a.

Turning to the Commission's decision to "pre-grant" permission for producers to abandon their service obligations, the court held that "the Commission has abdicated its responsibility under Section 7(b) of the NGA by providing for an across the board, pre-authorized abandonment provision." Pet. App. 28a. The court relied on "the absence of provisions for factual inquiry into the circumstances of an abandonment" and on the fact that Order No. 451 would "allow a producer, for all practical purposes, to control abandonment through the largely one sided GFN procedure." *Id.* The court found that this producer control was inconsistent with *United Gas Pipe Line Corp. v. McCombs,* 442 U.S. 529 (1979), and would mean in practice that automatic abandonment "would be used only when such utilization would serve the producer's economic interest." Pet. App. 28a.

With respect to Order No. 451's handling of the take-or-pay problem, the court of appeals observed that the Commission had relied on the reasoning set forth in Order No. 436 as the basis for its statement that "the natural forces of competition will resolve the issues surrounding high cost contracts." J.A. 68, *quoted at* Pet. App. 30a. The court of appeals further observed that the D.C. Cir-

cuit, in *Associated Gas Distributors v. FERC, supra*, 824 F.2d at 1023, had rejected Order No. 436 and its rationale, because the Order "failed to effectively address the take or pay problem." Pet. App. 30a. The court of appeals agreed with the D.C. Circuit and found Order No. 451 flawed for the same reason. Pet. App. 31a.

The court of appeals also rejected the Commission's claims that Order No. 451 "will serve to facilitate the renegotiation of high cost contracts." Pet. App. 31a. "Most damaging to the Commission's position," the court said, is the "one-sided nature of the GFN process." *Id.* at 31a-32a. "Surely producers would not initiate the GFN process if by so doing, they ran the risk of giving up more on new gas contracts than they would receive in return for their old gas." *Id.* at 32a. The court therefore found that "the prospect for exacerbating the take or pay problem runs rampant throughout the provisions of Order No. 451" and "that the Commission's inaction on the take or pay problem is based on a rationale which is arbitrary and unsupportable." *Id.*[14]

SUMMARY OF ARGUMENT

This case is not a basic rate case. Rather, the case raises fundamental issues about the nature of the Commission's obligation to adhere to the policies and procedures fixed by Congress. Although petitioners profess agreement with the principle that the Commission must follow Congress' command, the agency actions that petitioners seek to defend diverge markedly from what Congress intended.

In particular, the Commission, acting under color of two ratesetting provisions of limited significance, has attempted to overthrow the comprehensive and detailed pricing policies Congress prescribed in the NGPA to govern future natural gas regulation. Similarly, the Commission has abdicated its longstanding NGA regulatory supervision of the initiation and abandonment of natural gas service, a responsibility that Congress in the NGPA expressly chose to continue for old gas. The court of appeals correctly concluded that neither of these major departures from the congressional plan should be permitted to stand.

[14] Judge Brown dissented from the court of appeals' decision, disagreeing with virtually every conclusion reached by the court. *See* Pet. App. 36a-60a.

I.

The plain language, history, and purposes of the NGPA establish that Congress made an essential policy choice when it enacted the statute. It decided to balance producer and consumer interests by narrowly focusing price incentives to spur the development of new sources of gas supply. At the same time, Congress purposefully chose to withhold additional price incentives from old gas—*for which, by definition, investment decisions already had been made*—unless it otherwise qualified under an incentive-priced NGPA category.

In Orders No. 451 and No. 451-A, the Commission did just the opposite of what Congress intended. By collapsing the vintage prices for all categories of old gas into a single price equal to the highest vintage price, the Commission provided gargantuan price incentives to producers of old gas for the express purpose of stimulating old gas production, discouraging production of new gas, and allowing old gas prices to be set by the market.

Petitioners are wrong in asserting that the legality of the new ceiling price can be determined by examining only Sections 104(b)(2) and 106(c) of the NGPA, which give the Commission the authority to set old gas rates that are "just and reasonable within the meaning of the Natural Gas Act." As the court of appeals correctly held, the Commission is not free to ignore the structure and purpose of the statute as a whole, under the guise of exercising its ratemaking authority.

The Commission's sweeping changes in the NGPA's pricing program also conflict with the statute's legislative history, with the decisions of other courts of appeals

that have interpreted the NGPA, and with prior Commission interpretations of its own authority under the statute. Because Congress has directly addressed the issue presented, arguments about deference to the Commission's current interpretation are inapposite. Cases such as *Chevron, U.S.A. v. NRDC*, 467 U.S. 837 (1984), on which petitioners rely here for the first time, cannot salvage the Commission's action.

II.

Even if, as petitioners urge, this Court were to examine Sections 104 and 106 in isolation, Order No. 451 still would be invalid. The Commission has admitted that the new ceiling price for old gas would not be just and reasonable if it were actually collected by producers. The Commission's only answer to this incongruity is that the GFN procedure will prevent the new ceiling price from being collected. But as the court of appeals correctly found, the GFN is so biased in favor of producers that it cannot act as a meaningful restraint on prices. *Any time* the purchaser offers to pay less than the new ceiling price, the producer is free to end negotiations, terminate the existing contract, sell the gas to another purchaser, and, through the blanket certificate and abandonment procedures, permanently escape *all* future regulation under the Natural Gas Act. The court of appeals did not err in calling the GFN procedure what it is: a one-sided procedure that is "'clearly at odds with Congress' purpose to regulate the supply and price of natural gas.'" Pet. App. 28a, *quoting United Gas Pipe Line Co. v. McCombs*, 442 U.S. 529, 539 (1979).

The Commission's claim that the court of appeals did not disturb Order No. 451's conclusion that the new ceiling price was "just and reasonable" can only be based on an unnatural reading of the court's opinion. The court of appeals held that "the Commission has ignored congressional intent and exceeded its authority by allowing for de facto deregulation of old gas." Pet. App. 17a. That holding, fairly read in the context of the rest of the court's opinion, inevitably entails the conclusion that Order No. 451's new ceiling price was *not* "just and reasonable."

Moreover, petitioners are wrong in asserting that the validity of Order No. 451 depends primarily (1) on whether the Commission may set a single ceiling price applicable to all old gas (*i.e.*, whether it may eliminate vintaging), and (2) on whether the Commission may use a particular ratesetting methodology known as "replacement costs" to set ceiling prices for old gas. *See* FERC Br. 30-36; Producers Br. 18-23. The Court need not reach either question. As the Court has long recognized in the context of natural gas regulation under the just and reasonable rate standard, "it is the result reached and not the method employed which is controlling." *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944); *Duquesne Light Co. v. Barasch*, 109 S. Ct. 609, 620 (1989). The end result of Order No. 451 is unlawful deregulation of old gas pricing—and the means by which that impermissible result is accomplished are irrelevant.

III.

The Commission's proposal to permit the automatic, permanent abandonment of service obligations pursuant to the GFN procedure is also flawed. Section 7(b) of the Natural Gas Act provides that a requested abandonment can only be approved after "due hearing" and appropriate findings by the Commission. Under Order No. 451, by contrast, the decision to abandon lies in the producers' control, and is accomplished with no oversight and no individual hearing before the Commission.

Petitioners try to justify this scheme by arguing that the required "hearing" was the rulemaking proceeding that resulted in Order No. 451, and that the Commission has already made the necessary "finding" that *all* future abandonments are in the public interest, regardless of the effects they will have on the parties involved. This rationale cannot be squared with *United Gas Pipe Line Co. v. McCombs*, 442 U.S. 529 (1979),

which makes clear that there must be an opportunity for fact finding and a chance for parties to be heard *before* an abandonment can be approved. Indeed, even the cases cited by petitioners confirm that all affected parties must have the opportunity to show that the Commission's general abandonment policy should not apply in their case.

IV.

Finally, the court of appeals correctly ruled that Order No. 451 would exacerbate the problem of high-cost take-or-pay contract provisions and was therefore invalid. The court did not, however, order the Commission to "solve" this problem, or indeed to take any specific remedial action. Petitioner's claim of improper judicial intrusion into the Commission's affairs is without merit.

ARGUMENT

I. THE NEW PRICING STRUCTURE ADOPTED BY THE COMMISSION IN ORDER NO. 451 IS INCONSISTENT WITH THE REGULATORY SCHEME ENACTED BY CONGRESS IN THE NGPA.

A. Like Any Statute, the NGPA Must Be Read as a Whole.

Petitioners' principal argument is that "the court below disregarded the plain meaning of the relevant statutory provisions . . . ." FERC Br. 24; *see also* Producers Br. 18. In their view, only two NGPA provisions—Sections 104(b)(2) and 106(c)—control the outcome of this case, and those provisions can be properly understood in a vacuum, with only the aid of a dictionary. Petitioners focus primarily on eleven words within Sections 104(b)(2) and 106(c)—"just and reasonable within the meaning of the Natural Gas Act"—and act as if those words alone can establish the validity of the wholesale revision of natural gas pricing policies effected by Order No. 451. Petitioners are wrong. Their argument ignores the necessity of reading Sections 104(b)(2) and 106(c) in the context of the entire NGPA.

This Court has frequently rejected readings of a statute that focus on statutory phrases examined in isolation. Time and again, the Court has stressed that "the words of a statute must be read in their context and with a view to their place in the overall statutory scheme." *Davis v. Michigan Dept. of Treasury*, 109 S. Ct. 1500, 1504 (1989). As the Court said in *Pilot Life Insurance Co. v. Dedeaux*, 481 U.S. 41, 51 (1987), "in expounding a statute, we are not guided by a single sentence or member of a sentence, but look to the provisions of the whole law, and its object and policy" (*quoted with approval in Dole v. United Steelworkers*, 110 S. Ct. 929, 934 (1990), and *Massachusetts v. Morash*, 109 S. Ct. 1668, 1673 (1989)).[15]

When the NGPA is read as a whole, and Sections 104(b)(2) and 106(c) are interpreted from the perspective of their place in the full statutory scheme, those provisions cannot support Order No. 451. The NGPA did not, in two short provisions added with no debate at the very end of the legislative process, authorize the Commission to reverse the fundamental congressional decision not to deregulate old gas and not to provide broad new incentives for the continued production of such gas.

B. Read as a Whole, the NGPA Does Not Permit Petitioners' Interpretation of Sections 104(b)(2) and 106(c).

As this Court has held, the NGPA was "designed to supplant the Commission's authority to establish rates for the wholesale market . . . ." *Mid-Louisiana*, 463 U.S. at

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[15] *See also United States v. Morton*, 467 U.S. 822, 828 (1984) ("We do not, however, construe statutory phrases in isolation; we read statutes as a whole"); *Offshore Logistics, Inc. v. Tallentire*, 477 U.S. 207, 220-221 (1986); *Stafford v. Briggs*, 444 U.S. 527, 535 (1980); *Philbrook v. Glodgett*, 421 U.S. 707, 713 (1975); *Chemehuevi Tribe of Indians v. FPC*, 420 U.S. 395, 403 (1975); *Allied Chemical Workers v. Pittsburgh Plate Glass Co.*, 404 U.S. 157, 185 (1971); *Mastro Plastics Corp. v. NLRB*, 350 U.S. 270, 285 (1956); *Brown v. Duchesne*, 60 U.S. (19 How.) 183, 194 (1857).

331. The statute "establish[ed] an exhaustive categorization of natural gas production, and [set] forth a methodology for calculating an appropriate ceiling price within each category . . . ." *Id.* at 332. The exhaustive categorization established by Congress was purposeful. It evidenced Congress' intent to create a *comprehensive* pricing policy to govern future natural gas regulation—an intent that Congress confirmed through its extension of price controls to intrastate gas and through its establishment of a catch-all category (and ceiling price) for any natural gas not otherwise included in an NGPA category. *Transco,* 474 U.S. at 421; *Mid-Louisiana,* 463 U.S. at 332-333. Congress deliberately left no gaps for the Commission to fill.

Under the pricing scheme prescribed by Congress, "new" and "difficult-to-produce" natural gas, both of which are defined in intricate and extensive detail on the face of the NGPA, are entitled to increased ceiling prices "to provide investors with adequate incentives to develop new sources of supply." *Mid-Louisiana,* 463 U.S. at 334. Congress insisted that, before a producer could actually receive these incentive prices, it had to comply with the rigorous qualification procedures set out in Section 503, 15 U.S.C. § 3413, the lengthiest and most detailed provision of the NGPA.

Congress treated old gas very differently from new and difficult-to-produce gas. As this Court has observed, the NGPA "evinces careful thought about the extent to which producers of 'old gas' . . . would be able to enjoy incentive pricing." *Mid-Louisiana,* 463 U.S. at 334. Congress provided no new incentives for old gas, except to the extent a particular producer or a particular well could qualify for an incentive price under some provision of the statute other than Sections 104 and 106. As a senior DOE official recognized as recently as last year, "[t]o help maintain consumer prices, the NGPA kept price controls on gas discovered before April 1977. Thus, while the NGPA created incentives to produce high-cost

new gas, it prolonged *disincentives* for full production of low-cost old gas." *Natural Gas Price Controls: Hearing on H.R. 1595 before the Subcomm. on Energy and Power of the House Comm. on Energy and Commerce,* 101st Cong., 1st Sess. 13 (1989) (hereafter "*H.R. 1595 Hearing*") (testimony of J. Allen Wampler, Assistant Secretary for Fossil Energy) (emphasis added).

Congress' choice was eminently logical: incentives are to bring about an action not yet taken. "[S]ince producer-investment decisions with regard to [old] gas had already been made, there was no need to calibrate the price of that gas to the costliness of its production." *Consolidated Edison Co. v. FERC,* 823 F.2d 630, 633 (D.C. Cir. 1987). Congress therefore "directly incorporate[d] part of the 'vintaging' pattern that previously existed under the NGA . . . increased over time in accordance with the inflation formula found in § 101." *Mid-Louisiana* at 334-35.

In Order No. 451, the Commission turned the detailed and hard-fought congressional compromise on its head. The Commission admitted that a basic objective of its action was to stimulate the production of old gas, the great majority of which needs *no* additional incentive for continued production, and at the same time to discourage the production of new gas. J.A. 147. Substituting its own policy judgment for that of Congress, the Commission established a general "incentive" price for old gas.

The Commission readily acknowledged that it derived the new Order No. 451 ceiling by focusing on replacement costs, rather than historical costs. J.A. 81-83, 233, 237. Replacement costs are designed to measure what it would cost to find and develop new gas resources today. *See* Producers Br. 9 ("replacement cost measures the current cost of finding new gas fields, drilling new wells and producing new gas"). The replacement cost methodology is intended to produce an incentive price, and in fact, as used by the Commission in Order 451, it produced not

only an incentive price but a windfall substantially above what was needed to permit old gas producers to recover their investment plus a reasonable return.

The "incentive" ceiling price adopted for old gas in Order No. 451—and the average actual price currently being paid for old gas—exceed the price that a great deal of new gas production is receiving today. Indeed, the majority of new gas production is today deregulated as a result of Section 121 of the NGPA, and it therefore receives only a market price. That market price has been substantially below the Order No. 451 ceiling price ever since Order No. 451 was promulgated, and it remains so today, as petitioners concede. FERC Br. 28: Producer Br. 25. The bottom line is that the very gas for which Congress decided not to provide incentive prices is now covered by such prices, while much of the gas for which Congress expressly chose to provide incentives now has been deregulated in accordance with the congressional plan and is governed entirely by the market. The Commission has thus created "a system of price supports for producers" of old gas, in direct violation of congressional intent. *Martin Exploration*, 486 U.S. at 210.

Recent studies document the serious, anti-consumer impact of the Commission orders. In the nearly four years since the orders became effective, they have cost the public hundreds of millions of dollars in additional payments for old gas already dedicated to the interstate market.[16]

[16] The costs of Order No. 451 can be measured by the huge increases in old gas prices that have occurred since the order became effective. *See Gas Costs, Resale and Transportation Rates of Pipeline Companies—A Monthly Service*, Foster Associates (Jan. 25, 1989), Summary Table 4 (between March 1986 and January 1989, the price of old gas increased by 44%); Interstate Natural Gas Association of America, *The Washington Report*, No. 1450, at 9 (Sept. 29, 1989) (Order No. 451 led to a net gas cost increase of approximately $215 million in 1988 alone); *H.R. 1595 Hearing*, at 27 (DOE chart, a copy of which is reproduced in Appendix C, *infra*, shows that in 1987, after Order No. 451 became effective, the price of flowing, old gas jumped and exceeded average wellhead prices).

Petitioners' self-serving efforts to recast Order No. 451 as a pro-consumer measure (FERC Br. 13, 21; Producers Br. 26) are implausible on their face. The order is a tremendous boon to producers. That is why the producers support it. The order disfavors consumers. That is why every segment of the natural gas industry other than producers—including state regulatory commissions, state consumers advocates, other consumer protection organizations, local distribution companies, and interstate pipelines—oppose the Commission's action. This is not, as petitioners apparently maintain, a case in which neither side knows where its self-interest lies.

C. Prior Judicial Decisions Support the Court of Appeals' Construction of Sections 104 and 106.

Every court that has construed the pricing provisions of the NGPA has recognized the clear congressional purposes that are embodied in the statute. For example, in *Pennzoil Co. v. FERC*, *supra*, the Fifth Circuit stated that the NGPA "adopted an incentive-based approach to rate-setting for gas production, providing substantially higher prices for 'new' gas than was currently available. At the same time, the NGPA provided consumer protection by maintaining lower prices on flowing gas . . . ." 645 F.2d at 367 (footnote omitted). *See also Columbia Gas Development Corp. v. FERC*, 651 F.2d 1146, 1160 (5th Cir. 1981) (the NGPA "reflects a careful balance between two statutory principles: (1) incentive pricing for new gas . . . and (2) maintenance of NGA price controls on old gas to prevent unnecessary price increases").

The D.C. Circuit has reached the same conclusion. *See Interstate Natural Gas Association of America v. FERC*, 716 F.2d 1, 14-15 (D.C. Cir. 1983), *cert. denied*, 465 U.S. 1108 (1984) ("Congress itself specified the maximum lawful prices of most categories of gas and authorized the Commission to raise those prices only in certain, very limited, circumstances."); *See also Consolidated Edison Co. v. FERC*, *supra*, 823 F.2d at 633 ("[a]ll of the

legislators agreed that the regulatory structure of the [NGA] would continue to govern pre-NGPA 'old' gas").

Similarly, in *Martin Exploration Management Co. v. FERC*, 813 F.2d 1059, 1064 (10th Cir. 1987), *rev'd on other grounds*, 486 U.S. 204 (1988), the court of appeals stated:

> The NGPA established ceiling prices for each of [the] categories of natural gas production. In general, the lowest ceiling prices were for old gas, higher ceiling prices were established for new gas, and the highest ceiling prices were for difficult to produce gas. The purpose of creating different ceilings was to create an incentive to drill for new gas, particularly gas that is costly to produce.

See also ANR Pipeline Co. v. FERC, 870 F.2d 717, 719 (D.C. Cir. 1989) (Congress enacted the NGPA "to encourage the development of *new* sources of natural gas that would have proven uneconomic under existing [NGA] price ceilings") (emphasis added).

D. The Commission's Own Interpretations of the NGPA Prior to 1986 Are Inconsistent with Order No. 451.

As the earlier summary of the Commission's NGPA rulemaking proceedings shows (*see* pages 8-18, *supra*), the Commission did not write Orders No. 451 and No. 451-A on a blank slate. Dpring the eight years from the enactment of the NGPA to the issuance of Order No. 451, the Commisison took numerous actions and made numerous statements that run counter to the interpretation of the statute that the Commission now espouses.

First, the Commission conducted an extended rulemaking proceeding concerning the implementation of its authority under Sections 104(b)(2) and 106(c). The underlying assumption throughout that proceeding was that the provisions were intended to authorize the Commission to grant "special relief" to individual producers whose particular circumstances were such as to render the existing vintaged ceiling price inadequate and confiscatory. *See* pages 11-13, *supra; see also Permian Basin*, 390 U.S. at 770-774.

The Commission explictly stated its view that, when Congress included Sections 104(b)(2) and 106(c) in the NGPA, its purpose was to "provide[] a link between the NGA's special relief procedures and the NGPA . . . ." 49 Fed. Reg. at 29,910. The congressional aim was to make available "a 'safety valve' for area or national rates that might otherwise have been confiscatory." *Id.* at 29,912. The Commission reiterated that view in the course of its handling of individual applications for special relief. *See, e.g., A.O. Phillips*, 27 F.E.R.C. ¶ 61,463, at 61,728 (1984).

Now, in a self-serving effort to disavow its earlier position, the Commission labels this reading of Sections 104(b)(2) and 106(c) a "crabbed construction" (FERC Br. 29), and attempts to create the impression that the court of appeals invented this interpretation. FERC Br. 19. The Commission's argument is remarkable, in light of the fact that the Commission itself—not once, but several times—interpreted Sections 104(b)(2) and 106(c) as special relief measures.

Second, the Commission summarily rejected a producer-sponsored attempt to convert old gas priced under Sections 104 and 106 to gas qualifying for higher prices under Section 109, through the artifice of drilling an unnecessary "new" well in an old gas field. *See* the discussion of Order No. 72, at pages 13-14, *supra*. The Commission found that it would be "neither reasonable nor consistent with the pricing scheme of the NGPA" to allow old gas to receive the Section 109 price through this scheme. 45 Fed. Reg. at 18,918. It also concluded that applying the Section 109 price would violate the congressional plan to encourage the production of *new* gas, rather than to induce further capital investment for the production of old gas, which, by definition, was already available to the market. *Id.* at 18,917.

The Commission has reversed those policy decisions in Order No. 451. It has made the Section 109 ceiling price applicable to old gas generally and has thus enabled producers to obtain for old gas the very price that the Commission previously said was unreasonable. Under Order No. 451, the producers can obtain this price without even going through the effort and expense of drilling a "new" well, as they proposed to do in the Order No. 72 proceeding. The Commission has also decided that producers should now be allowed to receive an incentive price for old gas, despite the Commission's earlier recognition that this was contrary to congressional intent.

Third, in 1983, in Order No. 107-A, the Commission used its authority under Section 107(c)(5) of NGPA to establish an incentive price for the production of old gas through production enhancement techniques. *See* pages 14-16, *supra*. To ensure that the new incentive was "reasonable" and "necessary" to stimulate production of gas that otherwise would not be produced, the Commission imposed stringent substantive and procedural requirements that had to be met before a producer of old gas could qualify for the incentive. 48 Fed. Reg. 45,100.

The Commission set a *maximum* incentive ceiling for old gas to be produced through production enhancement techniques—a maximum that was equal to the ceiling price later adopted for all old gas in Order No. 451—and it provided that that ceiling would be *reduced* if the incremental production resulting from the incentive price involved costs per units of production that the Commission deemed prohibitive. *See* 18 C.F.R. 271.704.

The Commission also expressly distinguished the "special relief" authorized by Sections 104(c)(2) and 106(c) from the incentive prices authorized by Section 107. In the Commission's view, the special relief provisions "are intended to provide economic relief after the fact, that is, after the producer undertook to develop and produce gas," whereas the incentive prices authorized in Section 107 were "intended to provide an incentive *in advance* of

drilling activity to encourage production where it may not have been economically feasible." 48 Fed. Reg. at 45,101 (emphasis in original).

Now, by invoking its Section 104(b)(2) and Section 106(c) authority as a basis for Order No. 451, the Commission has in effect eliminated Section 107(c)(5) from the NGPA, at least as far as old gas is concerned. The Commission has given *all* old gas the maximum incentive it was ever prepared to allow under Section 107(c)(5) for old gas that qualified under the production enhancement rule, and it has done so without any guarantee that any additional gas will be produced or any production enhancement techniques used.

Fourth, in its so-called "block-billing" rulemaking, which proposed the apportioning of different categories of gas among different sectors of the market, the Commission acknowledged that Congress wanted the economic benefits associated with old gas to go to consumers, not producers, and the Commission further admitted that old gas prices were not to be left to market forces. In the Commission's words, old gas "is not market responsive *specifically by legislative intent*." 50 Fed. Reg. at 42,376 (emphasis added). Order No. 451 represented an abrupt about-face from this position.

E. The Legislative History of the NGPA Supports the Court of Appeals' Decision.

"The message conveyed by the plain language of [the NGPA] is confirmed by an examination of its history." *INS v. Cardoza-Fonseca*, 480 U.S. 421, 432 (1987). Although petitioners argue that the court of appeals relied on only some parts of the legislative history while ignoring others (*see* FERC Br. 36-38), there are two points about which there can be no genuine disagreement.

First, the NGPA was intended to be a compromise measure by Congress. As the court of appeals pointed out, the statute was the product of "some nineteen months of heated Capitol Hill debate" between the mem-

bers of Congress who favored deregulation and those who did not. Pet. App. 17a. This compromise included specific decisions about which categories of gas were to be free from price controls and which categories were to continue to be subject to price controls. The Commission may not undo this choice simply by claiming that its orders reflect a more rational and orderly scheme for regulating natural gas. As the Court has stated, "deciding what competing values will or will not be sacrificed to the achievement of a particular objective is the very essence of legislative choice—and it frustrates rather than effectuates legislative intent simplistically to assume that *whatever* furthers the statute's primary objective must be the law." *Rodriguez v. United States*, 480 U.S. 522, 526 (1987) (*per curiam*).

Second, there can be no dispute that the NGPA intended to establish a pricing structure that would encourage the production of *new* gas by raising prices for such gas and at the same time would protect consumers by ensuring that *old* gas prices remain low. As Senator Jackson, the Senate Manager of the conference committee bill explained, the NGA proposed "a policy which concentrates the rewards of higher prices where they are most needed —on the development of new, high cost gas . . . ." 124 Cong. Rec. 28,633 (1978). In this way, he said, the bill "will encourage production while protecting consumers from paying unnecessarily high prices for gas that they could expect to receive at lower prices under current policies." *Id.*[17]

[17] Similarly, Representative Dingell, the House Manager of the conference committee bill, stated that the focus of the NGPA is to bring "the greatest supply response at the least cost to consumers." 124 Cong. Rec. 38,361 (1978); *see also* 124 Cong. Rec. 28,884 (remarks of Senator Hart) (consumers should be protected by regulations that prevent the price of inexpensive old gas from rising); 124 Cong. Rec. 28,865 (1978) (remarks of Sen. Domenici) (elimination of vintaging and deregulation of old gas "not doable" or even suggested); 124 Cong. Rec. 29,108 (1978) (remarks of Senator

The two snippets of legislative history cited by the Commission (FERC Br. 37) consist of statements made by two Senators who opposed the NGPA and who played no leadership roles in its enactment. But "[t]his Court does not usually accord much weight to the statements of a bill's opponents." *Shell Oil Co. v. Iowa Department of Revenue*, 109 S. Ct. 278, 284 (1988). As the Court explained in *Schwegmann Brothers v. Calvert Distillers Corp.*, 341 U.S. 384, 394 (1951), and then repeated in *Gulf Offshore Co. v. Mobil Oil Corp.*, 453 U.S. 473, 483 (1981), "[t]he fears and doubts of the opposition are no authoritative guide to the construction of legislation."

In sum, Order No. 451 does precisely the opposite of what Congress intended: it attempts to bring down the price of new gas (thereby discouraging production) by raising the price of old gas. *See* J.A. 147. The legislative history merely adds compelling support to the conclusion that flows from the NGPA itself. Whether or not Order No. 451's alteration of the NGPA's priorities and goals was a good idea—and respondents submit that the order was not a prudent means of trying to encourage the production of low-cost old gas—it is dramatically different from what Congress had in mind when it passed the NGPA. It marks a major policy shift of the kind that can properly be effected only by Congress itself.[18]

McIntyre) ("This compromise . . . does provide substantial incentives for the production of more domestic natural gas. And at the same time it provides a measure of protection for consumers from sudden and unwarranted price increases").

The statement of Senator Domenici submitted to the Commission in the Order No. 451 rulemaking proceeding and now relied upon by petitioners (*see* Producers Br. 28-29) for the asserted purpose of "clarifying" statements made eight years earlier during the NGPA debate should be accorded no weight. Senator Domenici's *post hoc* rationalization of statements made during the debate cannot alter the statutory language or the intent of the Congress that enacted the NGPA.

[18] In fact, Congress has now taken such action, prospectively, in the Natural Gas Wellhead Decontrol Act of 1989, Pub. L. No. 101-60, 103 Stat. 157. *See* note 20, *infra*.

F. "Deference" to the Commission's Current Interpretation of the NGPA Is Not Appropriate.

A recurring theme in petitioners' briefs is that the court of appeals failed to defer to the Commission's reading of the NGPA, choosing instead to "substitute" its own interpretation of what the statute means. *See* FERC Br. 24-25; Producers Br. 14, 23, 30-31 (citing *Chevron U.S.A. v. NRDC*, 467 U.S. 837 (1984)). Although petitioners chastise the court of appeals for its alleged failure to adhere to the principles of *Chevron* (Producers Br. 14), it is worth noting that petitioners themselves have only recently discovered the supposedly dispositive effect of that decision. *Chevron* was not discussed or even cited in petitioners' briefs to the court of appeals.

In any event, *Chevron* does not help petitioners' position. It is not some magical incantation, the mere mention of which can divert the courts from their proper role in statutory interpretation. First and foremost, *Chevron* reconfirms the well-established proposition that, "[t]he judiciary is the final authority on issues of statutory construction and must reject administrative constructions . . . which are contrary to clear congressional intent." 467 U.S. at 843 n.9. *See also FEC v. Democratic Senatorial Campaign Committee*, 454 U.S. 27, 32 (1981) (courts, as final authorities on statutory construction, must reject interpretations "that are inconsistent with the statutory mandate or that frustrate the policy that Congress sought to implement").

In this case, because Congress has clearly spoken on the issues that are the subject of Orders No. 451 and No. 451-A, petitioners' arguments about "deference" to the Commission's interpretation of the NGPA are misplaced. *See, e.g., Regents of the University of California v. Public Employment Relations Board*, 485 U.S. 589, 602 (1988) ("Because we have been able to ascertain Congress' clear intent based on our analysis of the statutes and their legislative history, we need not address the issue of deference to the agency"). The language and purpose of the NGPA leave no doubt that Congress intended

to continue regulation of old gas and that it did not intend to provide broad new incentives for such gas.

In addition, Congress could not have been more clear about when price controls were to be removed from natural gas, and which categories of gas were to receive this treatment. In Section 121 of the NGPA, Congress provided a detailed description of the phased-in deregulation plan that Congress enacted as part of the NGPA compromise. Old gas covered by Sections 104 and 106(a) was not included in any of the Section 121 deregulation categories.

In the NGPA, Congress has deliberately and clearly chosen *not* to leave the regulatory scheme for the agency to devise. Congress replaced the Commission's broad regulatory authority under the NGA with a comprehensive and detailed prescription for how different categories of natural gas were to be treated after 1978. Congress set the course and the agency was obliged to adhere to it. As one federal judge wrote shortly before the NGPA was enacted, "A Congress genuinely concerned about delegated power has one effective contribution that it, and only it, can make—the identification and definition, as precisely as possible, of that power, and of the standards to be observed in its exercise." C. McGowan, *Congress, Court and Control of Delegated Power*, 77 Colum. L. Rev. 1119, 1174 (1977). Here, Congress provided a precise program, and the Commission was not free to disregard and replace it.[19]

Petitioners urge the Court nevertheless to ignore the NGPA as a whole, and simply to determine whether the

[19] Refusing to defer to the Commission is especially appropriate here, because Orders No. 451 and No. 451-A are inconsistent with the Commission's own prior contemporaneous interpretations of the NGPA, as shown in detail above. As this Court has long recognized, "[a]n agency interpretation of a relevant provision which conflicts with the agency's earlier interpretation is 'entitled to considerably less deference' than a consistently held agency view." *INS v. Cardoza-Fonseca*, 480 U.S. 421, 446 n.30 (1987), quoting *Watt v. Alaska*, 451 U.S. 259, 273 (1981).

Commission's interpretation of Sections 104(b)(2) and 106(c) is reasonable under *Chevron.* But as the Court made clear just last term, an agency may not rely on this kind of flexible standard to justify a result that is inconsistent with the congressional scheme.

In *Maislin Industries, U.S. v. Primary Steel,* 110 S. Ct. 2759 (1990), the Interstate Commerce Commission ("ICC") had construed its organic statute to relieve shippers of the duty to pay the freight rates that were on file with the ICC, if the shipper had privately negotiated a lower rate with a carrier. This interpretation was based in large part on the ICC's authority to determine when rates were "reasonable." *See id.* at 2767. The ICC concluded that the practice of trying to collect the filed rates was itself "unreasonable" if the parties had negotiated a lower price. This determination, said the ICC, was entitled to deference because it was not specifically prohibited by the statute, and because it was "reasonable." *Id. at* 2768 (citing *Chevron,* 467 U.S. at 843).

This Court disagreed. Among other things, the Court found that the carriers' duty to file rates, and the shippers' duty to pay those rates, were "utterly central" to the structure and purpose of the statute, and that any attempt to circumvent these duties was inconsistent with both the "statutory scheme as a whole," and certain sections of the statute in particular. 110 S. Ct. at 2768, 2769. And, while the ICC argued that this interpretation had become outdated as a result of statutory amendments that were designed to increase competitiveness in the industry, the Court made clear that it was not the agency's role to determine what Congress *should* have intended or *would* have intended, but only what it *actually* intended: "If strict adherence to §§ 10761 and 10762 as embodied in the filed rate doctrine has become an anachronism in the wake of the [new statute], it is the responsibility of Congress to modify or eliminate these sections." *Id.* at 2771.

This reasoning is equally applicable to the current case. The "statutory scheme as a whole" leaves no doubt that

meaningful regulation of old gas prices was to continue and that Congress did not intend to provide new incentives for the production of old gas. The quality of the Commission's reasons for adopting a contrary approach is therefore irrelevant. Even if, as the Commission claims, the "anachronistic, multi-tiered system of vintage pricing" has contributed to problems in the natural gas industry (FERC Br. 20), it is for Congress, not the Commission, to resolve this problem.[20]

II. EVEN IF VIEWED SOLELY FROM THE PERSPECTIVE OF THE "JUST AND REASONABLE" PROVISIONS IN SECTIONS 104(b)(2) AND 106(c), ORDER NO. 451 CANNOT STAND.

This Court long has recognized that "[u]nder the statutory standard of 'just and reasonable' it is the result reached and not the method employed which is controlling." *FPC v. Hope Natural Gas Co.,* 320 U.S. 591, 602 (1944); *see also Permian Basin,* 390 U.S. at 775; *Duquesne Light Co. v. Barasch,* 109 S. Ct. 609, 617 (1989) (it is not the theory but the impact of the rate order that counts). Petitioners pay lip service to the *Hope* "end result" test, but then proceed to ignore it by arguing about the theory underlying Order No. 451, rather than about the order's actual impact. *See* FERC Br. 31-33; Producers Br. 21-23.

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[20] Congress in fact has elected to change the NGPA pricing policies, and it has done so by enacting the Natural Gas Wellhead Decontrol Act of 1989. Pub. L. No. 101-60, 103 Stat. 157. Under this statute, the price controls on all natural gas, including all old gas, will be eliminated entirely on January 1, 1993. Private parties can, however, "deregulate" old gas through negotiation at any time beginning on July 26, 1989. *See* Section 2(a), 103 Stat. 157.

Given that Congress has specifically determined *when* price restraints are to be removed, and *how* that is to occur, and given that the Commission has attempted to remove price restraints several years earlier, and has devised its own GFN procedure for doing so, the Commission's belief that the Wellhead Decontrol Act "confirms the soundness" of Order No. 451 (FERC Br. 49) is difficult to fathom.

When Order No. 451 is evaluated in terms of its practical effect, the entire order—and especially its sharp increase in the ceiling price applicable to old gas—cannot qualify as "just and reasonable within the meaning of the Natural Gas Act." This is so for two different, but related, reasons.

First, the new ceiling price cannot be "just and reasonable" under the NGA, because it is a rate that the Commission itself believes should not be collected. This is contrary to the very essence of a "just and reasonable" rate under the NGA, which by definition is a rate that is to be charged and collected.

Second, the impact of Order No. 451 is to deregulate old gas, and to leave the sale, pricing, and abandonment of such gas almost entirely to market forces. This outcome cannot be "just and reasonable" in light of Congress' clear intent to continue regulation of old gas and to use the "just and reasonable" language as a means of perpetuating the NGA's regulatory regime.

A. The Order No. 451 Ceiling Price Cannot Be "Just and Reasonable," Because the Commission Has Conceded that the Price Should Not Be Collected.

By the Commission's own admission, the new Order No. 451 ceiling price is a price that should not be collected. The Commission expressly found that actual collection of the new ceiling price as a result of price escalator clauses "would distort the market as much as current artificially low ceiling prices." J.A. 141. Accordingly, the Commission declared that producers with escalator clauses "should not automatically receive the new ceiling price." *Id.; see also id.* at 310. The Commission concluded that consumers needed to be "protected" from the new ceiling price, and it devised the GFN procedures for the avowed purpose of providing such protection. The Commission's brief confirms this point. *See* FERC Br. 13-15, 21, 40, 42.

The Commission's recognition of the need to protect consumers from the new ceiling price underscores the defects in Order No. 451. The entire point of "just and reasonable" rate regulation is the establishment of a rate that, if collected, will protect purchasers through a proper balance of consumer and producer interests. *Permian Basin,* 390 U.S. at 776. The fact that the Commission felt obliged to create a negotiation procedure to ameliorate the effects of the Order No. 451 ceiling price shows that that price is not "just and reasonable" within the meaning of the NGA.

What the Commission essentially did in Order No. 451 was to assert that, for old gas, a new "just and reasonable" rate existed somewhere between the existing rate and the new ceiling price. The Commission declined, however, to say what the "just and reasonable" rate was and, through the GFN procedure, it ensured that it would play no role in establishing that rate. The Commission did not engage in "just and reasonable" *ratemaking* at all; rather it sought to create a *rate negotiating* process, to avoid the new ceiling that the Commission itself set.

As the Commission said in Order No. 451, the GFN procedure was adopted "as an integral part of the new ceiling price itself . . . ." J.A. 43. The Commission asserted that the procedure would permit market factors to serve as the actual determinants of the rates to be charged for old gas and would thus help to prevent the new ceiling price from actually appearing in the marketplace.

But just and reasonable ratemaking under the NGA does not involve the creation of hypothetical rates that would be unjust and unreasonable if actually collected. Under Sections 4 and 5 of the NGA, the Commission is obliged to prescribe just and reasonable rates that can actually be "demanded, observed, charged, or collected . . . ." 15 U.S.C. § 717d(a). The "just and reasonable" standard cannot be satisfied by a rate whose use the Commission believes must be discouraged.

The inability of the Order No. 451 ceiling price to satisfy the "just and reasonable" standard becomes even more apparent when the obvious defects in the GFN procedure itself are considered. Because that procedure is hopelessly skewed in favor of the producers, it cannot possibly fulfill the role that the Commission envisioned. In fact, the procedure can be and has been used to extract from some purchasers the very ceiling price that the Commission thought should not be collected. *See, e.g.*, the documents reproduced in the appendix to respondents' brief in opposition, at 17a-30a.

The court of appeals correctly found that the GFN process has no appreciable impact on producers' ability to command the new ceiling price from purchasers. *See* Pet. App. 13a-15a, 31a-32a. The apparent theory behind the GFN procedure was that *if* producers and purchasers had relatively equal bargaining strength, the price that would result from their negotiations would be somewhere near the market price, and thus below the new ceiling price. *See* J.A. 295-297. In fact, however, the GFN process grants almost all bargaining power to the producer. Only the producer can initiate the process. He does so by asking the purchaser to nominate a new contract price. If the purchaser nominates any price *other* than the new ceiling price, the producer has the unfettered right to terminate the contract, sell the gas to a new buyer, and automatically abandon its sales obligations to its existing customer. J.A. 159-160. To describe this procedure as "negotiation" stretches that term beyond its reasonable meaning.[21]

The Commission has attempted to respond to the clear defects in the GFN procedure with four arguments designed to show that the purchaser actually has a "de-

[21] Nor is there even a requirement that producers act in "good faith." There is no mechanism in the Orders to ensure or even examine whether the producer is deliberately attempting to exploit its purchasers by insisting on above-market prices. The producer's state of mind is irrelevant. The name "good faith" negotiations is only a label, not a requirement.

cisive role" in the process. FERC Br. 42. None of these arguments has merit.

First, the Commission points out that "the GFN procedure was included in the Order to protect *purchasers* from the consequences of automatic price-escalation clauses." Regardless of how well-intentioned the Commission may have been, however, its motive is irrelevant to whether the GFN procedure actually affords purchasers any meaningful protection.

Second, the Commission argues that once the GFN process is triggered, "if the purchaser signals an intent to continue to purchase old gas at a mutually agreed-upon price, the producer cannot 'unilaterally' abandon sales." This point simply ignores the central problem of the procedure, which is that the producer has *no* incentive to reach any "mutually agreed-upon price" other than the new ceiling price, and may use the threat of termination and abandonment to obtain it. The fact that a producer can be prevented from abandoning its obligation if the customer agrees to the producer's terms, *i.e.*, agrees to pay the new ceiling price, is sparse protection indeed. To obtain the "protection" touted by the Commission, the customer must agree to pay the very price against which the GFN procedure is supposed to be protecting.

Third, the Commission claims that once the GFN procedure is invoked, a purchaser "may often" realize substantial benefits, because the procedure gives the purchaser the "opportunity to reopen the price terms of any contract with the producer that involves the sales of some old gas, including contracts that expose the purchaser to take-or-pay liability." But, as the court of appeals correctly observed (Pet. App. 28a), this "opportunity" will rarely, if ever, be of use to a purchaser, because it is the producer who has the sole right to initiate the GFN process, and only a producer that is unable accurately to assess its own self-interest would be likely to initiate the

process in a situation where it might help the purchaser more than the producer.

Finally, the Commission makes the related argument that the purchaser has "an important reciprocal right" that supposedly corresponds to the producer's right of abandonment: if the parties do not reach an agreement on price, the purchaser may terminate any other contract it has with the producer, as long as the other contract involves some old gas. This, the Commission implies, may enable a purchaser to rid itself of some undesirable contracts covering a small amount of old gas and a greater quantity of high-cost new gas. The initial problem, of course, is that, as the Commission admitted (J.A. 317, 320), most high-cost take-or-pay contracts that present problems for pipeline purchasers involve *only new* gas and thus cannot qualify as so-called "multi-vintage" contracts covered by the Commission's rule. More important, even if a pipeline has entered into such multi-vintage contracts, the GFN procedure is unlikely to provide protection. Just as a producer is unlikely to initiate the GFN process unless it will serve the producer's economic interest, so a producer is unlikely to terminate a contract and abandon a service obligation unless it believes that the result of the entire process, including any possible termination by the purchaser, will favor the producer. *See* Pet. App. 31a-32a.

In short, when the GFN procedure is evaluated on the basis of its actual operation, the Commission cannot credibly maintain that "concerns about the fairness of the GFN . . . are unfounded" (FERC Br. 42).

B. Order No. 451's New Ceiling Price for Old Gas Is a Central Feature of the Commission's Unauthorized Deregulation of Old Gas and Therefore Is Not "Just and Reasonable."

Under *Hope's* "end result" test, Order No. 451 should be examined as a whole, and the dramatic increase in the ceiling price for old gas should be considered as a major part of the Commission's overall plan to discontinue old

gas regulation. Order No. 451 cannot survive scrutiny from this perspective.

In the NGPA, Congress decided to continue rate regulation for old gas. Sections 104 and 106 preserved the existing pricing structure for such gas, and Section 601, 15 U.S.C. § 3431, did not include old gas in the list of gas categories to which the provisions of the NGA would no longer apply. The result was to make clear that Congress expected the Commission (1) to continue to exercise its ratemaking authority under Sections 4 and 5 of the NGA, within the bounds fixed by Sections 104 and 106 and the rest of the NGPA, and (2) to continue its traditional certificate and abandonment regulatory responsibilities under Section 7 of the NGA.

Yet the Commission has in virtually every respect sought to walk away from its regulatory obligations under the statute. It has increased the ceiling price for old gas to a level so far above the market that the ceiling plays no effective role in regulating prices. It has permitted automatic abandonments of service obligations, with no opportunity for affected persons to be heard in opposition. In fact, it has granted an across-the-board advance authorization for abandonment even of service that has not yet begun to customers that have not yet been identified.

Similarly, the Commission has granted blanket certificates of public convenience and necessity, in advance, for any sale, now or in the future, of any gas that is released from its existing customer, under the GFN process. With respect to such gas, the Commission has also completely relieved producers of any obligation to file their rates, make their contracts available for public inspection, and charge only the rates on file. Likewise, the Commission has surrendered its authority to investigate whether the rates actually charged for released old gas are just and reasonable. Producers are not obliged even to inform the Commission of such rates, much less to submit them for the Commission's review. J.A. 46.

In a fundamental sense, the action taken by the Commission in Order No. 451 parallels the "negotiated rates" policy established by the ICC and recently rejected by this Court in *Maislin Industries, U.S. v. Primary Steel*, 110 S. Ct. 2759 (1990). Relying on statutory amendments that in its view were designed to create a "more competitive environment," the ICC attempted to justify its decision to relieve shippers of the obligation to pay the rate on file with the agency, whenever the shipper had privately negotiated a lower rate with a carrier. The Court held that the ICC's pro-competitive policy choice could not be reconciled with the regulatory mandate embodied in the ICC's governing statute.

The ICC attempted to authorize wholesale departures from the filed rate system established by Congress. It essentially contended that it had built a better mousetrap, and that the underlying objective of promoting competition would be better served by the agency's approach than by continued regulation through filed rates. The Court ruled, however, that the ICC was not free to substitute its choices for those of Congress. Similarly, the Commission in the present case should be compelled to withhold price incentives from, and continue comprehensive NGA regulation of, old gas.

In the course of the Order No. 451 rulemaking proceeding, the Commission admitted that it lacked the authority simply to announce that all old gas prices would henceforth be set by the market. The Department of Justice ("DOJ") urged the Commission to declare that *any price* paid for gas subject to Sections 104 and 106 of the NGPA would be presumed "just and reasonable" within the meaning of the NGA. J.A. 170. The Commission agreed that "market-based rates" were desirable, but it concluded that the DOJ proposal was "beyond its authority." *Id.* at 170-171. The Commission conceded that "Congress did not intend to give the Commission authority to deregulate old gas prices completely . . .," and

it purported to accept the D.C. Circuit's statement that "[i]f a decision is to be made to deregulate natural gas prices, it must be made by Congress, not by the [Commission] . . . ." *Public Service Commission v. FERC*, 589 F.2d 542, 550 (D.C. Cir. 1978), quoted at J.A. 171. The Commission then went ahead, however, and deregulated old gas.

By substantially increasing the ceiling price for old gas in an effort to encourage old gas prices to be determined by the market, the Commission abandoned "just and reasonable" ratemaking and ran directly counter to the decisions of this Court. As the Court recognized in *FPC v. Texaco*, 417 U.S. 380, 397 (1974), "the prevailing price in the market place cannot be the final measure of 'just and reasonable' rates mandated by the [NGA]." *See also Shell Oil Co. v. FPC*, 520 F.2d 1061, 1084 (5th Cir. 1975), *cert. denied*, 426 U.S. 941 (1976). The "just and reasonable" standard requires "meaningful rate regulation", and "presumed market forces may not comprise the principal regulatory constraint." *Farmers Union Central Exchange, Inc. v. FERC*, 734 F.2d 1486, 1507, 1530 (D.C. Cir.), *cert. denied*, 469 U.S. 1034 (1984).

Given the Commission's admission that the DOJ deregulation proposal was unlawful, the Commission's ultimate action in Order No. 451 is inexplicable. The Commission apparently believes that, although the *elimination* of a price ceiling would constitute improper deregulation, a price ceiling that has been set so high that it provides no meaningful price restraint *is* a proper exercise of its regulatory powers. *See* FERC Br. 34. This is not a legitimate distinction. As the Court has stated, a "price ceiling can only impose a direct legal restraint if the market price [is] above the price ceiling." *Martin Exploration*, 486 U.S. at 210. *See also Farmers Union Central Exchange, Inc. v. FERC*, *supra*, 734 F.2d at 1507 n.47 ("ratemaking that sets charges at levels 'seldom . . . reached in actual practice' and which is 'peripheral to

the pricing process' is at best a hair's breadth from total deregulation").[22]

Although the Commission attempts to persuade the Court that Sections 104(b)(2) and 106(c) of the NGPA authorized its deregulatory action, the Commission acknowledges that these provisions were added to the statute late in the legislative process (FERC Br. 38), and it cites no evidence that the purpose of the amendment was to grant the Commission sweeping authority to deregulate the very gas that Congress had chosen to keep regulated. That would have been an extraordinary development. It would have substantially changed, at the eleventh hour, the legislative compromise hammered out in 19 months of debate. It is inconceivable that Congress would have so changed the statute without providing some description and explanation of what it was doing.

By far the more plausible explanation is the one that the Commission itself embraced during the eight years after the NGPA was enacted: Sections 104(b)(2) and 106(c) were intended to modify the House bill, which made no provision for subsequent increases (other than adjustments for inflation) in the old gas price ceilings, and to provide a link to the NGA's "special relief" procedures. *See* pages 11-13, 38-39, *supra*. The point was that the existing NGA price ceilings applied generally to entire vintages of old gas. Although a particular ceiling might well have been "just and reasonable" for a vintage considered as a whole, it might have worked a hardship for a particular well, whose circumstances may have been

[22] In fact, to the extent that the GFN procedure enables producers of old gas to obtain prices above market levels, the effect of Order No. 451 is even worse than deregulation. This fact highlights the conflict between the Commission's Order and the NGPA. Throughout Congress' deliberations on the statute, "[t]he operating assumption . . . was that deregulation was the most favorable regime for gas producers under consideration." *Martin Exploration*, 486 U.S. at 210-211. As this Court emphasized just two years ago, "[n]ot one participant in the legislative process suggested that producers should receive higher prices than deregulation would afford them." *Id.* at 210.

different from those of most wells in the vintage. The NGA "special relief" procedures were intended to deal with that kind of situation, and Sections 104(b)(2) and 106(c) carried the concept over to the NGPA.[23] *See also Permian Basin*, 390 U.S. at 770-774.

In trying to bring Order No. 451 under the "just and reasonable" umbrella, petitioners make a series of involved, and sometimes inaccurate, arguments, about the Commission's historical practices in regulating gas rates. They concentrate extended attention on the history of vintaging and on the Commission's different cost methodologies in the rate-setting process. In the final analysis, however, none of these arguments can overcome the clear practical effect of Order No. 451, the "end result" that is dispositive under *Hope*. That "end result" is a sweeping deregulation of old gas prices, abandonments, and sales. It is not what Congress intended to permit under the "just and reasonable" provisions of the NGPA; it is not what Congress intended in excluding old gas from the Section 121 price decontrol provisions; and it is not what Congress intended in preserving NGA certificate and abandonment regulation for old gas.

III. THE AUTOMATIC ABANDONMENT PROVISIONS OF ORDER NO. 451 VIOLATE SECTION 7(b) OF THE NGA.

A. In Order No. 451, the Commission Broadly Disclaimed Its Regulatory Authority over Abandonment of "Old Gas" Facilities and Service.

The Commission did not confine its effort to deregulate old gas simply to price decontrol. In direct contravention

[23] Particularly in light of its own extended "special relief" rulemaking under Sections 104(b)(2) and 106(c), and its years of experience with the NGA "special relief" procedures, it is disingenuous in the extreme for the Commission now to claim to be unable to understand how a "just and reasonable" ceiling price for a particular vintage of old gas could ever become confiscatory. *See* FERC Br. 30. A vintage-wide ceiling price could preclude a producer from recovering its costs on a particular well, even while being a "just and reasonable" ceiling for the vintage generally.

of Section 601 of the NGPA, 15 U.S.C. § 3431, it also elected to cast aside Congress' decision to continue traditional NGA regulation over old gas. Among the important NGA controls specifically preserved by the NGPA are the abandonment requirements of Section 7(b), 15 U.S.C. § 717f(b). In Order No. 451, the Commission decided simply to discard these requirements, as unnecessary rituals of a bygone era.

Under Section 7(b) of the NGA, natural gas companies, such as producers making wholesale sales of old gas into the interstate market, are forbidden from abandoning facilities or service subject to the jurisdiction of the Commission without first obtaining the Commission's approval "after due hearing, and a finding by the Commission that the available supply of natural gas is depleted to the extent that service is unwarranted, or that the present or future public convenience or necessity permit such abandonment." 15 U.S.C. § 717f(b).

In Order No. 451, the Commission authorized pregranted abandonment for all future sales of old gas following release of such gas under the GFN procedure. J.A. 46. The breadth of the Commission's action appears clearly in the Order and is not disputed. Not only is the initial GFN abandonment automatically approved, but once an "old gas" service obligation has been abandoned under the GFN procedure, the gas involved is forever free of Section 7(b) requirements. This is true regardless of how many different customers may purchase the gas at different times in the future and regardless of what hardships discontinuance of serve to such customers may cause.

When the broad abandonment authorization is considered together with the blanket certificate that the Commission simultaneously provided for all future sales to new customers, there can be no reasonable doubt that the goal of Order No. 451 was to remove the remaining NGA controls from old gas and to relieve the Commission from the regulatory role it had always played under the statute.

B. Section 7(b) Is Intended to Ensure that Abandonment Can Occur Only after Interested Persons Have Had an Opportunity to Be Heard and the Commission Has Made Specific Findings.

This Court's decision in *United Gas Pipe Line v. McCombs*, 442 U.S. 529 (1979) (hereafter "*McCombs*"), makes clear that Congress entrusted the Commission with significant *mandatory* duties under Section 7(b). "Congress could not have been more explicit in establishing Commission approval as a prerequisite for lawful abandonment." *Id.* at 535-536. Noting that the express language of Section 7(b) not only "require[s] companies to obtain the 'approval of the Commission . . . after due hearing,' but . . . also prohibits abandonment absent specific findings by the Commission," the Court held that "[t]he language of Section 7(b) simply does not admit of any exception to the statutory procedure." *Id.*

The Court also ruled that the Commission's legal control over the continuation of service is "a *fundamental component of the regulatory scheme*," and that "[t]o deprive the Commission of this authority, *even in limited circumstances*, would *conflict with basic policies underlying the Act*." 442 U.S. at 538 (emphasis added). The Court explained that Section 7(b)'s "due hearing" requirement "permits all interested parties to be heard and therefore facilitates full presentation of the facts necessary to determine whether § 7(b)'s criteria have been met." *Id.* In the absence of an opportunity for factual inquiry into the merits of producer abandonments, the Court concluded, "the abandonment determination would rest, as a practical matter, *in the producer's control*, a result *clearly at odds with Congress' purpose* to regulate the supply and price of natural gas." *Id.* at 539 (emphasis added).

Enactment of the NGPA did not alter or diminish the regulatory mandate under Section 7(b), as applied to all old gas committed and dedicated to interstate commerce. *McCombs*, 442 U.S. at 536 n.9. Rather, the NGPA pre-

served the Commission's responsibilities under Section 7(b).

Petitioners do not contest this point. *See* FERC Br. 39; Producers Br. 32, 33. Instead, they claim that the Commission's across-the-board advance authorization of abandonment complies with the requirements of the statute. When Order No. 451 is measured against the standards and purpose of Section 7(b), however, it falls far short.

C. The Commission's Rulemaking Hearing on Order No. 451 Did Not Satisfy the "Due Hearing" and "Specific Findings" Requirements of Section 7(b).

Petitioners argue that the rulemaking proceeding conducted in connection with Order No. 451 satisfied the procedural requirements of Section 7(b). FERC Br. 42-44; Producers Br. 33, 35-42. They contend that the Commission only addressed "legislative-type" issues and not "historical fact" issues in the rulemaking and that therefore no further procedures are required for any future abandonment.

In fact, however, the Commission's own description of what it did in the Order No. 451 rulemaking confirms the deficiencies in the process. Under Section 7(b) the Commission may not restrict its attention exclusively to "legislative-type" issues applicable to the industry as a whole. It may not act, as it did in Order No. 451, solely on the basis of amorphous market generalizations, without any regard for specific, concrete examples of the actual impact of the abandonment procedures on particular services—services that, by definition, the Commission had previously certificated under Section 7(c) of the NGA as in the "public convenience and necessity." 15 U.S.C. § 717f(c).

Section 7(b), was not intended to address market generalities. It was designed to ensure that *all* interested parties—not just the immediate parties to the contract—would have an opportunity to be heard and to make a full

presentation of the facts before any abandonment could occur. *McCombs*, 442 U.S. at 538. The Commission's pregrant of abandonment authority in Order No. 451 did not serve this statutory purpose.

By 1986, when the order was issued, many "old gas" service obligations had existed for many years. They were the very kinds of service arrangements that Congress sought to protect in Section 7(b), for the benefit of the broad class of consumers served by the interstate natural gas market. *See, e.g., McCombs*, 442 U.S. at 535-536, 538-539; *California v. Southland Realty Co.*, 436 U.S. 519, 526-527 (1978); *Sunray Mid-Continent Oil Co. v. FPC*, 364 U.S. 137, 142-143 (1960); *Coastal Oil & Gas Corp. v. FERC*, 782 F.2d 1249, 1252-1253 (5th Cir. 1986). Yet, the Commission, without hearing anything about the likely consequences of the abandonment of any of these obligations, authorized the abandonment of each and every one of them.

The Commission did not find, and indeed could not have found based on the record before it, that *every* future abandonment of old gas service would be consistent with the public convenience and necessity, taking into account the abandonment's probable effects on consumers and all other interested persons. Rather, the Commission found, at most, that in its view the public convenience and necessity would be better served if the Commission did not review future abandonments under Section 7(b) to determine whether they would satisfy the public convenience and necessity standard.

The Commission, in other words, used its authority to regulate to decide not to regulate. But that is not a position that the Commission could properly adopt. Congress made the choice that the Commission *should* review abandonments before they occur, and the Commission may not say in response, "it would be better if we didn't." *See Public Service Commission v. FPC*, 511 F.2d 338, 354 (D.C. Cir. 1975) ("There may be reason for the legislature to enact a deregulation for the natural gas industry,

but so long as it prescribes a system of regulation by an agency subject to court review[,] the courts may not abandon their responsibility by acquiescing in a charade or rubber stamping of non-regulation in agency trappings") (Leventhal, J.).

There is a further, related reason why the Order No. 451 automatic abandonment rule cannot be reconciled with the explicit requirements of Section 7(b). By authorizing literally thousands of abandonments on a permanent basis with no opportunity for Commission review of—or even passing notice of—the fundamental consumer interests affected by the abandonments (*see Atlantic Refining Co. v. Public Service Commission*, 360 U.S. 378, 388 (1959)), the Commission placed the entire abandonment decision squarely in the hands of the producer. This was the very vice that this Court found unacceptable in *McCombs*, 442 U.S. at 539 (placing the abandonment determination in the producer's control is "a result clearly at odds with Congress' purpose"). In ruling that Order No. 451 does not comport with the requirements of Section 7(b), the court of appeals correctly stressed this conflict between the order and the Court's rationale in *McCombs*. *See* Pet. App. 27a, 28a.

The Commission's shallow and distorted reading of Section 7(b) is epitomized by its attempt to reconcile its treatment of abandonments with the *McCombs* opinion. *See* FERC Br. 40 n.15. The Commission tries to distinguish Order No. 451 abandonment from that disapproved in *McCombs* on the ground that in *McCombs* the Commission had not approved the proposed abandonment, whereas under Order No. 451 the Commission has approved in advance all possible abandonments of old gas service. The Commission cannot satisfy its statutory responsibilities under Section 7(b), however, merely by making an express decision to *forever* disassociate itself from direct control over, or specific review of, countless potential abandonments of dedicated service, thus ensuring its ignorance of specific circumstances and equities. Whether or not the Commission characterizes that decision as "prior approval," it does not fulfill the Commission's regulatory obligation under Section 7(b).

D. The Commission Has Made No Provision for Individual Exceptions to Its Abandonment Rule.

Petitioners claim to find further support for their position that the Order No. 451 "hearing" satisfies the "due hearing" requirement of Section 7(b) in several decisions of this Court, including *Heckler v. Campbell*, 461 U.S. 458 (1983); *FPC v. Texaco*, 377 U.S., 33, 40 (1964); and *United States v. Storer Broadcasting Co.*, 351 U.S. 192 (1956). None of these cases, however, supports petitioners' claim. In each of the cases cited by petitioners, the determinative factor in the Court's decision to uphold an agency's use of general rulemaking, rather than case-by-case proceedings, was the agency's express provision of an opportunity for affected parties to demonstrate that the generalized regulation should *not* apply to them. That opportunity for specialized treatment, however, is wholly absent from the Commission's automatic abandonment rule contained in Order No. 451.

In *Heckler v. Campbell, supra*, this Court considered the question whether the Secretary of Health and Human Services could rely on published medical vocational guidelines to determine a claimant's right to social security benefits. The Court found that the Secretary could rely on such guidelines, but was quick to explain "that the regulations afford claimants ample opportunity both to present evidence relating to their own abilities and to offer evidence that the guidelines do not apply to them." 461 U.S. at 467. Similarly, the Court observed (461 U.S. at 467 n.11), the decisions in *FPC v. Texaco, supra*, and *United States v. Storer Broadcasting Co., supra*, "were careful to note that the statutory scheme at issue allowed an individual applicant to show that the rule promulgated should not be applied to him." *See also Permian Basin*, 390 U.S. at 770.

By contrast, the automatic abandonment rule provides no such opportunity. The best that petitioners are able

to say is that a person who objects to a proposed abandonment may complain that "the conditions specified in [Order No. 451] as prerequisites to receiving the Commission's approval are not present . . . ." FERC Br. 44; *see also* Producers Br. 41 n.21. But that, of course, fails to answer respondents' point. The concern is not that the Commission will approve an abandonment that does not comply with Order No. 451 (that problem is unlikely to arise, given the ease with which the order allows producers to abandon); rather, the concern is that abandonments *will* comply with Order No. 451 but *will not* serve the public convenience and necessity, in light of all the circumstances and equities involved. Order No. 451 provides no means of dealing with that kind of situation, and *Campbell*, *Texaco*, and *Storer* therefore provide no support for the Commission's automatic abandonment rule.

E. The Remaining Authorities on which Petitioners Rely Also Do Not Support Their Interpretation of Section 7(b).

Petitioners assert that various precedents of this Court and the federal courts of appeals justify advance approval of the abandonment of certificated services at the option of the producer, based not upon any individual circumstances, but solely upon generic policy findings. The cited cases hold otherwise.

For example, in *FPC v. Moss*, 424 U.S. 494 (1976), this Court only confirmed the authority of the Commission to grant both initial sales and abandonment authority at the time an individual natural gas sales certificate was granted. *Id.* at 496. The Court in *Moss* emphasized that the Commission had not sought to authorize any specific abandonment, but only to establish a procedure under which pre-granted abandonment "may be authorized in appropriate cases." *Id.* at 501. The Court noted, however, that any Commission orders approving the pre-granted abandonment would have to be supported by substantial evidence, consistent with Section 7(b), and subject to judicial review. *Id.* at 501-502.

Kansas Power & Light Co. v. FERC, 851 F.2d 1479 (D.C. Cir. 1988), affirming the Commission's policy of granting limited-term abandonments ("LTAs") in some circumstances, also provides no support for petitioners. That decision approved the issuance of LTAs filed on a pipeline-by-pipeline, or producer-by-producer basis, not a blanket, nationwide basis. Moreover, the LTAs were based on *mutual agreement* between pipelines and producers and were subject to strict controls. *See id.* at 1482 ("all the abandonment authorizations carried strict time (one year or less) limits, and producers were required to report periodically to the Commission on any sales made under the LTA program"). The court of appeals affirmed the Commission's denial of a hearing because under these circumstances any potential harm to consumers could be addressed in a prudence inquiry concerning the pipeline's decision voluntarily to agree to the LTA. The court concluded that the "allegations of possible future harm were too speculative to warrant a preauthorization adjudicative hearing and that any challenges to the LTAs would most logically be conducted in the pipelines' rate proceedings." *Id.* at 1484. The issue addressed in *Kansas Power & Light* was therefore completely different from that presented here.

Petitioners' reliance upon *Associated Gas Distributors v. FERC*, 824 F.2d 981 (D.C. Cir. 1987), *cert denied*, 485 U.S. 1006 (1988) (hereafter "*AGD*"), is also misplaced, for two reasons. First, the "pre-granted abandonment" at issue in that case can only occur at the election of the customer. Second, upon further judicial review of the same pre-granted abandonment regulations, in *American Gas Association v. FERC*, No. 87-1588 (D.C. Cir. Aug. 24, 1990), the D.C. Circuit clarified its prior ruling and remanded the issue to the Commission. Significantly, in defending these pre-granted abandonment provisions, the Commission had committed itself to considering on a case-by-case basis whether a deviation from the general rule was necessary, and the Commission had already determined that a factual inquiry was needed "to determine

whether a pipeline might be able to use its monopoly power to [local distribution companies'] detriment." Slip. op. at 42. Despite that "safety valve," the Court nonetheless remanded the pre-granted abandonment provisions, for the Commission to consider further whether the rule would adequately protect consumers. In stark contrast, Order No. 451 provides *no* opportunity for fact-specific inquiry into individual cases in which abandonment could harm not just the purchasing pipeline, but consumers and others as well.

Finally, petitioners rely on the revised abandonment standard announced in *Felmont Oil Corp.*, 33 F.E.R.C. ¶ 61,333, at 61,657 (1985), *rev'd on other grounds sub nom. Consolidated Edison Co. v. FERC*, 823 F.2d 630 (D.C. Cir. 1987). *Felmont* does not support the Commission's authority to make a generic policy determination that in all future cases the *permanent* release and abandonment of gas supplies will serve the public convenience and necessity. Instead, *Felmont* illustrates the need to provide a meaningful opportunity for a hearing in the individual circumstances of contested abandonments.

The Commission in *Felmont* announced "a shift in the identification of the public interest, from the interest of only specific customers to the interests of the market as a whole, and in the determination of how the public's needs are best served." 33 F.E.R.C. at 61,657. This "shift" did not dispense with the need for individual proceedings, however. *Felmont* retained the traditional factors considered by the Commission in evaluating abandonments, even though it broadened the definition of the public interest and the way in which those factors would be weighed.

> By adopting this new policy, the Commission does not reject the prior abandonment policies *in toto*. The list of factors which the Commission considered in the past, such as environmental and economic consequences of abandonment, the parties' contract arrangements, and the parties' comparative needs, will still be weighed.

33 F.E.R.C. ¶ 61,333 at p. 61,657.[24]

Taken together or separately, the cases cited by petitioners fail to support their position. Rather, they demonstrate the unprecedented nature of the Commission's action in Order No. 451 and thus tend to confirm the invalidity of that action under Section 7(b.).

IV. THE COURT OF APPEALS CORRECTLY DETERMINED THAT ORDERS NO. 451 AND NO. 451-A WERE FLAWED BECAUSE THEY EXACERBATED THE PROBLEM OF HIGH-COST TAKE-OR-PAY PROVISIONS.

The court of appeals found that among the many flaws in Order No. 451 was the Commission's failure to address the "take-or-pay" issue in a meaningful way. Although the Commission recognized that the problematical take-or-pay contracts could create significant difficulties for pipelines, the Commission nonetheless concluded that the "problem contracts are primarily a matter for resolution between the parties involved" (J.A. 68), and that "the natural forces of competition" would resolve the difficulties. *Id.*

The court of appeals concluded that this explanation was inadequate, finding that "the Commission's inaction on the take or pay problem is based on a rationale which is arbitrary and unsupportable." Pet. App. 32a. This conclusion was hardly surprising; at the time of the court's decision, the D.C. Circuit had already issued several opinions that specifically rejected the Commission's "*laissez-faire*" rationale and found it an inadequate re-

[24] The Commission also ruled in *Felmont* that appropriate conditions could be imposed on abandonments, on a case-by-case basis, "in order to mitigate the loss to the dedicated purchasers." 33 F.E.R.C. at 61,657. Order No. 451, of course, makes no provision for the imposition of any such conditions to ameliorate the effects of the automatic abandonments authorized in advance by the Commission.

sponse to the take-or-pay issue. *See AGD*, 824 F.2d at 1023; *Consolidated Edison Co. v. FERC, supra*, 823 F.2d at 639-642. The court of appeals simply agreed with the D.C. Circuit that the Commission's approach reflect[ed] questionable legal premises and fail[ed] to meet the requirement of 'reasoned decisionmaking.'" *AGD*, 824 F.2d at 1023, *quoted at* Pet. App. 31a.

The Commission points out that it now has taken steps to address the take-or-pay issue, in proceedings initiated after the issuance of Orders No. 451 and No. 451-A. FERC Br. 46 & n.18. And the D.C. Circuit has recently affirmed certain aspects of the regulatory procedures devised by the Commission in these subsequent proceedings. *See American Gas Association v. FERC*, No. 87-1588 (D.C. Cir. Aug. 24, 1990).[26] As the Commission admits, however, the D.C. Circuit has also invalidated "one of the Commission's central initiatives" designed "to reduce overall take-or-pay liabilities and to allocate take-or-pay costs equitably among all levels of the natural gas industry," thus creating new uncertainties concerning the take-or-pay issue. FERC Br. 46; *see Associated Gas Distributors v. FERC*, 893 F.2d 349 (D.C. Cir. 1989), *cert. pending*, No. 89-2016 (filed June 22, 1990).

In any event, these subsequent developments do not change the fact that the court below acted properly. The one tangible action taken by the Commission *in Order No. 451* to address the take-or-pay problem—the so-called "multi-vintage" provision in the GFN procedure—did not and could not provide effective take-or-pay relief. This is because approximately two-thirds of the contracts giving rise to the take-or-pay problem involved only new

[26] In the *American Gas Association* case, the D.C. Circuit affirmed the Commission's decision to provide pipelines with a means for offsetting outstanding take-or-pay liabilities with a producer any time the pipeline transports gas for the producer. The regulations implementing this decision, however, specifically prohibit a pipeline from receiving any relief based on its continued transportation of gas that was previously committed to the pipeline but was released under the GFN procedure of Order No. 451.

gas and thus were not covered by the multi-vintage provision, as the Commission itself admitted. J.A. 317, 320. Moreover, as the court of appeals correctly observed, only producers can initiate the GFN procedure, and they surely would not do so "if by so doing they ran the risk of giving up more on new gas contracts than they would receive in return for their old gas." Pet. App. 32a.

In response, petitioners claim that the court of appeals acted beyond its authority, because its opinion "appeared to require the Commission to address and solve the take-or-pay problem as a condition precedent to the lawful promulgation of Order No. 451." FERC Br. 45-46. *See also* Producers Br. 46. Petitioners argue that the court below has in effect "direct[ed] the Commission to reorder its regulatory priorities", by ordering it to solve the take-or-pay problem in the current proceedings, rather than in some other proceeding of the Commission's choosing. *See* FERC Br. 46, 48. Petitioners claim that this alleged directive violates the principles set forth in *Vermont Yankee Nuclear Power Corp. v. NRDC*, 435 U.S. 519 (1978), and *FPC v. Sunray DX Oil Co.*, 391 U.S. 9 (1968) (noting Commission's discretion to address take-or-pay in pipeline proceedings rather than producer proceedings).

Petitioners have greatly misstated the court of appeals' ruling. Nothing in the opinion below requires the Commission to find a "comprehensive" solution to the take-or-pay problem before it could "deal with the pricing of old gas." *See* Producers Br. 46. The court of appeals' determination was in fact more limited: the court simply concluded, in assessing the reasonableness of Order No. 451, that the Commission's new proposal for pricing old gas (in particular the GFN procedure) would exacerbate the take-or-pay problem. Because the Commission's justification for compounding this problem was "unsupportable," and because the orders had not otherwise attempted to mitigate the take-or-pay problem, the court concluded that the Commission's inaction was "regrettable and unwarranted." Pet. App. 31a. This

criticism, however, was plainly directed at the Commission's rationale for its orders—an issue that was squarely before the court—not at its failure to solve all relevant problems in a single proceeding.

Thus, there is no inconsistency between the decision below and *Vermont Yankee* or *Sunray DX Oil.* The court of appeals did not order the Commission to reorder its priorities, alter its procedures, or indeed take any action at all. *See Motor Vehicle Manufacturing Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 50 (1983) (*Vermont Yankee* is not a "talisman under which any agency decision is by definition unimpeachable").

The court of appeals' discussion of the take-or-pay issue, which is supported by substantial evidence, provides no basis for vacating the decision below. It simply provides an additional reason why Order No. 451 cannot be upheld.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted,

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APPENDICES

APPENDIX A

STATUTORY PROVISIONS INVOLVED

1. Title I of the Natural Gas Policy Act of 1978, as codified at 15 U.S.C. §§ 3311 *et seq.*, provides, in pertinent part:

TITLE I—WELLHEAD PRICING

Subtitle A—Wellhead Price Controls

Sec. 101. Inflation Adjustment; Other General Price Ceiling Rules.

(a) ANNUAL INFLATION ADJUSTMENT FACTOR.—

(1) GENERAL RULE.—For purposes of this title, the annual inflation adjustment factor applicable for any month shall be the sum of—

(A) a factor equal to one hundredth of the quarterly percent change in the GNP implicit price deflator; plus

(B) a correction factor of 1.002.

(2) QUARTERLY PERCENT CHANGE IN THE GNP IMPLICIT PRICE DEFLATOR.—For purposes of paragraph (1)—

(A) IN GENERAL.—The term "quarterly percent change in the GNP implicit price deflator", when used with respect to any month, means the quarterly percent change in the GNP implicit price deflator, computed and published as an annual rate by the Department of Commerce, for the most recent calendar quarter for which such quarterly percent change has been so published at least 8 days before the beginning of such month.

(B) MONTHS BEFORE ENACTMENT.—For purposes of applying such term with respect to any

month in any calendar quarter which ends before the date of the enactment of this Act and for which a quarterly percent change in the GNP implicit price deflator has been published by the Department of Commerce as of such date of enactment, the quarterly percent change in the GNP implicit price deflator for the calendar quarter in which such month occurs shall be used in lieu of the quarterly percent change in the GNP implicit price deflator for a preceding calendar quarter.

(3) GNP IMPLICIT PRICE DEFLATOR.—For purposes of paragraph (2)—

(A) IN GENERAL.—The term "GNP implicit price deflator" means, except as provided in subparagraph (B), the preliminary estimate of the implicit price deflator, seasonally adjusted, for the gross national product, as computed and published by the Department of Commerce for the calendar quarter involved.

(B) MOST RECENT DATA AVAILABLE ON ENACTMENT.—The most recent revision, if any, of such implicit price deflator which has been so published before the date of the enactment of this Act, shall be used in lieu of the preliminary estimate of such implicit price deflator.

(b) RULES OF GENERAL APPLICATION.—

(1) DEPTH.—Except where otherwise provided, the depth of the completion location of any well shall be the true vertical depth, measured from the surface location of the well.

(2) COMMERCIAL QUANTITIES.—In determining whether production of natural gas has occurred in commercial quantities, quantities of natural gas produced from a well and used for the testing of such

well or for other field uses which are production related shall not be taken into account.

(3) COMPUTATION OF MONTHLY EQUIVALENT.—For purposes of computing any price under this title, the monthly equivalent of any factor shall be the twelfth root of such factor.

(4) APPLICATION OF CEILING PRICES.—The maximum lawful ceiling prices under this title—

(A) shall only apply to natural gas produced in the United States;

(B) shall apply to the month of delivery without regard to the date of the sale or the date of the contract under which the sale occurs; and

(C) shall not apply to deliveries occurring before the first day of the first month beginning after the date of the enactment of this Act.

(5) SALES QUALIFYING UNDER MORE THAN ONE PROVISION.—If any natural gas qualifies under more than one provision of this title providing for any maximum lawful price or for any exemption from such a price with respect to any first sale of such natural gas, the provision which could result in the highest price shall be applicable.

(6) COMPUTATION AND PUBLICATION OF CEILING PRICES.—The Commission shall—

(A) not later than 5 days before the beginning of any month, compute and make available the maximum lawful prices prescribed under this title for such month and the monthly equivalent of the annual inflation adjustment factor for such month, and

(B) as soon as possible thereafter, publish such maximum lawful prices and such factor for such month in the Federal Register.

(7) ROUNDING.—Any maximum lawful price under this title shall be computed to the nearest mill (rounding any fraction thereof which is one-half a mill or higher to the next highest mill).

(8) COMPUTATION OF INITIAL CEILING PRICES.—In computing any maximum lawful price under the provisions of this title for the first month for which such provisions take effect, if the initial maximum lawful price is established by reference to any month before such month, such maximum lawful price shall be computed as if such provisions had been in effect during each such prior month.

(9) EFFECT ON CONTRACT PRICE.—In the case of—

(A) any price which is established under any contract for the first sale of natural gas and which does not exceed the applicable maximum lawful price under this title, or

(B) any price which is established under any contract for the first sale of natural gas which is exempted under subtitle B of this title from the application of a maximum lawful price under this title,

such maximum lawful price, or such exemption from such a maximum lawful price, shall not supersede or nullify the effectiveness of the price established under such contract.

Sec. 102. Ceiling Price for New Natural Gas and Certain Natural Gas Produced from the Outer Continental Shelf.

(a) APPLICATION.—The maximum lawful price computed under subsection (b) shall apply to any first sale of natural gas delivered during any month in the case of—

(1) new natural gas; and

(2) natural gas produced from any old lease on the Outer Continental Shelf and qualifying under subsection (d) for the new natural gas ceiling price.

(b) MAXIMUM LAWFUL PRICE.—The maximum lawful price under this section for any month shall be—

(1) $1.75 per million Btu's, in the case of April 1977; and

(2) in the case of any month thereafter, the maximum lawful price, per million Btu's, prescribed under this subsection for the preceding month multiplied by the monthly equivalent of a factor equal to the sum of—

(A) the annual inflation adjustment factor applicable for such month; plus

(B)(i) .035, in the case of any month beginning before April 20, 1981; or

(ii) .04, in the case of any month beginning after April 20, 1981.

(c) DEFINITION OF NEW NATURAL GAS.—

(1) GENERAL RULE.—For the purposes of this section, the term "new natural gas" means each of the following categories of natural gas:

(A) NEW OCS LEASES.—Natural gas determined in accordance with section 503 to be produced from a new lease on the Outer Continental Shelf.

(B) NEW ONSHORE WELLS.—Natural gas determined in accordance with section 503 to be produced (other than from the Outer Continental Shelf) from—

(i) any new well which is 2.5 miles or more (determined in accordance with paragraph (2)) from the nearest marker well; or

(ii) any completion location, of any new well, which is located at a depth at least 1,000 feet below the deepest completion location of each marker well within 2.5 miles (determined in accordance with paragraph (2)) of such new well.

(C) NEW ONSHORE RESERVOIRS.—

(i) GENERAL RULE.—Except as provided in clauses (ii) and (iii), natural gas determined in accordance with section 503 to be produced (other than from the Outer Continental Shelf) from a reservoir from which natural gas was not produced in commercial quantities before April 20, 1977.

(ii) BEHIND-THE-PIPE EXCLUSION.—Clause (i) shall not not apply to natural gas produced from any reservoir if—

(I) the reservoir was penetrated before April 20, 1977, by an old well from which natural gas or crude oil was produced in commercial quantities (whether or not such production was from such reservoir); and

(II) natural gas could have been produced in commercial quantities from such reservoir through such old well before April 20, 1977.

(iii) WITHHELD GAS EXCLUSION.—Clause (i) shall not apply to natural gas produced from any reservoir—

(I) if such natural gas is produced through an old well; and

(II) subject to clause (iv), suitable facilities for the production and deliv-

ery to a pipeline of such natural gas were in existence on April 20, 1977.

(iv) EMERGENCY SALE FACILITIES.—The criteria of clause (iii) (II) shall not be considered to be met by reason of the existence of production and delivery facilities which were installed to carry out sales and deliveries of natural gas—

(I) under section 6 of the Emergency Natural Gas Act of 1977; or

(II) under the emergency sale authority pursuant to Opinion 699-B issued by the Federal Power Commission under section 7(c) of the Natural Gas Act.

(2) DETERMINATIONS OF DISTANCE.—For purposes of determining distance from any new well to any marker well—

(A) SURFACE LOCATION TO SURFACE LOCATION.—The measurement shall be the horizontal distance from the surface location of the new well to the surface location of the marker well—

(i) in any case in which the new well meets requirements for the nondirectional drilling of wells prescribed by the appropriate State or Federal agency having regulatory jurisdiction over the drilling of such well; or

(ii) in any case in which—

(I) the surface drilling of such new well began on or after February 19, 1977;

(II) production of natural gas in commercial quantities began from such

well before the date of the enactment of this Act; and

(III) the drilling of such well was not subject to any requirement regarding directional or nondirectional drilling, or the drilling of such well was subject to requirements regarding directional drilling but such requirements did not necessitate the obtaining of any permit or other certificate before drilling began.

(B) COMPLETION LOCATION TO SURFACE LOCATION.—In the case of any new well which is not covered by subparagraph (A), the measurements shall be the horizonal distance from—

(i) the closest point of any completion location of the new well, vertically projected to the same elevation as the surface location of the nearest marker well; to

(ii) the surface location of such marker well.

(3) DETERMINATION OF COMMERCIAL QUANTITIES.—For purposes of determining whether production of natural gas has occurred in commercial quantities under paragraph (1)(C)—

(A) a rebuttable presumption exists that production from a reservoir in commercial quantities has not occurred if natural gas has not been sold and delivered from such reservoir before April 20, 1977; and

(B) quantities of natural gas sold in interstate commerce (within the meaning of the Natural Gas Act) shall not be taken into account if such quantities were sold before the date of the enactment of this Act—

(i) under section 6 of the Emergency Natural Gas Act of 1977; or

(ii) under the emergency sale authority pursuant to Opinion 699-B issued by the Federal Power Commission under section 7(c) of the Natural Gas Act.

(4) NEW WELLS WHICH ARE ALSO MARKER WELLS.—For purposes of applying paragraph (c)(1)(B)(ii) in the case of any marker well which is also a new well under section 2(3)(B), the reference in such paragraph (c)(1)(B)(ii) to the deepest completion location of any marker well shall be deemed to be a reference to any subsurface location from which natural gas was produced in commercial quantities after January 1, 1970, and before February 19, 1977.

(d) OCS GAS QUALIFYING FOR NEW NATURAL GAS CEILING PRICE.—For purposes of this section—

(1) OCS RESERVOIRS DISCOVERED ON OR AFTER JULY 27, 1976.—Natural gas determined in accordance with section 503 to be produced from an old lease on the Outer Continental Shelf shall qualify for the new natural gas ceiling price if such natural gas is produced from a reservoir which was not discovered before July 27, 1976.

(2) RESERVOIRS PENETRATED BEFORE JULY 27, 1976.—For purposes of paragraph (1), a reservoir shall be considered as having been discovered before July 27, 1976, if—

(A) such reservoir was penetrated by a well before July 27, 1976; and

(B) with respect to such well—

(i) the results of any production test meeting the requirements of OCS Order No. 4 demonstrate that, as of the time of such

test, the reservoir is capable of producing in paying quantities (within the meaning of such Order);

(ii) any production capability evidence meeting the requirements of OCS Order No. 4 demonstrates that, as of the time such evidence is obtained, the reservoir is capable of producing in paying quantities (within the meaning of such Order); or

(iii) subject to paragraph (3), an induction-electric log, sidewall cores and core analysis, or a wire line formation test indicates that, as of the time of such test, the reservoir is commercially producible.

(3) EFFECT OF NEGATIVE PRODUCTION CAPABILITY TESTS.—For purposes of paragraph (1), a reservoir shall not be considered as having been discovered before July 27, 1976, by the penetration of such reservoir by a well before July 27, 1976, if, with respect to such well—

(A) a production test meeting the requirements of OCS Order No. 4 was performed and the results of such test fail to demonstrate that, as of the time of such test, such reservoir was capable of producing in paying quantities (within the meaning of such Order); and

(B) production capability evidence meeting the requirements of OCS Order No. 4 does not exist or, if existing, does not demonstrate that, as of the date such evidence was obtained, such reservoir was capable of producing in paying quantities (within the meaning of such Order).

(4) BURDEN OF PROOF.—For purposes of paragraph (1), the producer shall have the burden of showing that—

(A) no test described in paragraph (2)(B)(i) or (iii) was performed and no evidence described in paragraph (2)(B)(ii) or (iii) exists; or

(B) if any such test was performed or such evidence exists, the results of such test or such evidence do not provide the applicable demonstration or indication specified under paragraph (2).

(5) DEFINITION OF OCS ORDER NO. 4.—For purposes of this subsection, the term "OCS Order No. 4" means the order numbered 4 of the Conservation Division, Geological Survey, Department of the Interior, as approved by the Chief of the Conservation Division on August 28, 1969.

(e) EXCLUSION OF CERTAIN ALASKA NATURAL GAS.—The preceding provisions of this section shall not apply to any natural gas produced from the Prudhoe Bay Unit of Alaska and transported through the natural gas transportation system approved under the Alaska Natural Gas Transportation Act of 1976.

Sec. 103. Ceiling Price for New, Onshore Production Wells.

(a) APPLICATION.—In the case of natural gas determined in accordance with section 503 to be produced from any new, onshore production well, the maximum lawful price computed under subsection (b) shall apply to any first sale of such natural gas delivered during any month.

(b) MAXIMUM LAWFUL PRICE.—

(1) GENERAL RULE.—The maximum lawful price under this section for any month shall be—

(A) $1.75 per million Btu's, in the case of April 1977; and

(B) in the case of any month thereafter, the maximum lawful price, per million Btu's prescribed under this paragraph for the preceding month multiplied by the monthly equivalent of the annual inflation adjustment factor applicable for such month.

(2) PRODUCTION AFTER 1984 FROM WELLS 5,000 FEET OR LESS IN DEPTH.—Effective beginning with the month of January 1985 and in any month thereafter, in the case of any first sale of natural gas which was not committed or dedicated to interstate commerce on April 20, 1977, and which is produced from a new, onshore production well from a completion location located at a depth of 5,000 feet or less, the maximum lawful price under this section for any such natural gas delivered during any month shall be a price which is midway between—

(A) the maximum lawful price, per million Btu's, computed for such month under section 102 (relating to new natural gas); and

(B) the maximum lawful price, per million Btu's, computed for such month under paragraph (1).

(c) DEFINITION OF NEW, ONSHORE PRODUCTION WELL. —For purposes of this section, the term "new, onshore production well" means any new well (other than a well located on the Outer Continental Shelf)—

(1) the surface drilling of which began on or after February 19, 1977;

(2) which satisfies applicable Federal or State well-spacing requirements, if any; and

(3) which is not within a proration unit—

(A) which was in existence at the time the surface drilling of such well began;

(B) which was applicable to the reservoir from which such natural gas is produced; and

(C) which applied to a well (i) which produced natural gas in commercial quantities or (ii) the surface drilling of which was begun before February 19, 1977, and which was thereafter capable of producing natural gas in commercial quantities.

(d) EXCLUSION OF CERTAIN ALASKA NATURAL GAS.— The preceding provisions of this section shall not apply to any natural gas produced from the Prudhoe Bay Unit of Alaska and transported through the natural gas transportation system approved under the Alaska Natural Gas Transportation Act of 1976.

Sec. 104. Ceiling Price for Sales of Natural Gas Dedicated to Interstate Commerce.

(a) APPLICATION.--In the case of natural gas committed or dedicated to interstate commerce on the day before the date of the enactment of this Act and for which a just and reasonable rate under the Natural Gas Act was in effect on such date for the first sale of such natural gas, the maximum lawful price computed under subsection (b) shall apply to any first sale of such natural gas delivered during any month.

(b) MAXIMUM LAWFUL PRICE.—

(1) GENERAL RULE.—The maximum lawful price under this section for any month shall be the higher of—

(A)(i) the just and reasonable rate, per million Btu's, established by the Commission which was (or would have been) applicable to the first sale of such natural gas on April 20, 1977, in the case of April 1977; and

(ii) in the case of any month thereafter, the maximum lawful price, per million Btu's, prescribed under this subparagraph for the preceding month multiplied by the monthly equivalent of the annual inflation adjustment factor applicable for such month, or

(B) any just and reasonable rate which was established by the Commission after April 27, 1977, and before the date of the enactment of this Act and which is applicable to such natural gas.

(2) CEILING PRICES MAY BE INCREASED IF JUST AND REASONABLE.—The Commission may, by rule or order, prescribe a maximum lawful ceiling price, applicable to any first sale of any natural gas (or category thereof, as determined by the Commission) otherwise subject to the preceding provisions of this section, if such price is—

(A) higher than the maximum lawful price which would otherwise be applicable under such provisions; and

(B) just and reasonable within the meaning of the Natural Gas Act.

Sec. 105. Ceiling Price for Sales Under Existing Intrastate Contracts.

(a) APPLICATION.—The maximum lawful price computed under subsection (b) shall apply to any first sale of natural gas delivered during any month in the case of natural gas, sold under any existing contract or any successor to an existing contract, which was not committed or dedicated to interstate commerce on the day before the date of the enactment of this Act.

(b) MAXIMUM LAWFUL PRICE.—

(1) GENERAL RULE.—Subject to paragraphs (2) and (3), the maximum lawful price under this section shall be the lower of—

(A) the price under the terms of the existing contract, to which such natural gas was subject on the date of the enactment of this Act, as such contract was in effect on such date; or

(B) the maximum lawful price, per million Btu's, computed for such month under section 102 (relating to new natural gas).

(2) CONTRACT PRICE EXCEEDING NEW GAS CEILING PRICE ON ENACTMENT.—In the case of any natural gas described in subsection (a) for which the contract price applicable on the date of the enactment of this Act exceeds the maximum lawful price, per million Btu's, computed for such date under section 102 (relating to new natural gas), the maximum lawful price under this section shall be the higher of—

(A) the maximum lawful price, per million Btu's, computed for such month under section 102; or

(B)(i) the contract price on the date of the enactment of this Act, in the case of the month in which this Act is enacted; and

(ii) in the case of any month thereafter, the maximum lawful price, per million Btu's, prescribed under this subparagraph for the preceding month multiplied by the monthly equivalent of the annual inflation adjustment factor applicable for such month.

(3) PRICE INCREASES RESULTING FROM INDEFINITE PRICE ESCALATOR CLAUSES.—

(A) IN GENERAL.—Effective January 1985, and each month thereafter, in the case of any first sale of natural gas, which is sold at a price established under any indefinite price escalator clause of any existing contract or successor to an existing contract and for which the contract price on December 31, 1984, is higher than $1.00 per million Btu's, the maximum lawful price under this section for any such natural gas delivered during any month shall be the higher of—

(i) the maximum lawful price, per million Btu's, computed under paragraph (2) (B); or

(ii) (I) In the case of January 1985, the maximum lawful price, per million Btu's, computed under section 102 (relating to new natural gas) for such month; and

(II) in the case of any month thereafter, the maximum lawful price, per million Btu's, prescribed under this clause for the immediately preceding month multiplied by the monthly equivalent of the sum of a factor equal to the annual inflation adjustment factor applicable for such month plus .03.

(B) DEFINITION OF INDEFINITE PRICE ESCALATOR CLAUSE.—For purposes of this paragraph, the term "indefinite price escalator clause" includes any provision of any contract—

(i) which provides for the establishment or adjustment of the price for natural gas delivered under such contract by reference to other prices for natural gas, for crude oil, or for refined petroleum products; or

(ii) which allows for the establishment or adjustment of the price of natural gas

delivered under such contract by negotiation between the parties.

(C) CONTRACT MODIFICATIONS AFTER MAY 3, 1978, TO BE DISREGARDED.—In the case of any natural gas which was subject to any contract on May 3, 1978, that contained an indefinite price escalator clause on such date, no amendment to or modification of the operation of such contract made after such date may have the effect of limiting or precluding the application of this paragraph on or after January 1, 1985, to prices allowed with respect to such natural gas.

(D) EXCLUSION.—Subparagraph (A) shall not apply to any first sale of new natural gas (as defined in section 102(c)), stripper well natural gas (as defined in section 108(b)), high-cost natural gas (as defined in section 107 (c)), natural gas produced from a new, onshore production well (as defined in section 103 (c)) from a completion location located at a depth of more than 5,000 feet, and, beginning July 1, 1987, or, if later, the date of expiration of any price controls reimposed under section 122, natural gas produced from any new, onshore production well (as defined in section 103 (c)) from a completion location located at a depth of 5,000 feet or less.

(c) DEFINITION OF CONTRACT PRICE.—For purposes of this section, the term "contract price", when used with respect to any specific date, means—

(1) the price paid, per million Btu's, under a contract for deliveries of natural gas occurring on such date; or

(2) if no deliveries of natural gas occurred under such contract on such date, the price, per million

Btu's, that would have been paid had such deliveries occurred on such date.

Sec. 106. Ceiling Price for Sales Under Rollover Contracts.

(a) INTERSTATE ROLLOVER CONTRACTS.—In the case of any first sale under any rollover contract of natural gas which was committed or dedicated to interstate commerce on the day before the date of the enactment of this Act, the maximum lawful price under this subsection for such natural gas delivered during any month shall be the higher of—

(1) (A) in the case of the month in which the effective date of such rollover contract occurs, the just and reasonable rate, if any, per million Btu's, established by the Commission and applicable on such date to the natural gas subject to the expired contract; and

(B) in the case of any month thereafter, the maximum lawful price, per million Btu's, prescribed under this paragraph for the preceding month multiplied by the monthly equivalent of the annual inflation adjustment factor applicable for such month; or

(2) (A) \$0.54 per million Btu's, in the case of April 1977; and

(B) in the case of any month thereafter, the maximum lawful price, per million Btu's, prescribed under this paragraph for the preceding month multiplied by the monthly equivalent of the annual inflation adjustment factor applicable for such month. For purposes of this subsection, the term "rollover contract" includes any contract which would have been a rollover contract but for the fact that the expiration of the previous contract occurred prior to the day before the date of the enactment of this Act.

(b) INTRASTATE ROLLOVER CONTRACTS.—

(1) GENERAL RULE.—In the case of any first sale under any rollover contract of natural gas which was not committed or dedicated to interstate commerce on the day before the date of the enactment of this Act, the maximum lawful price under this subsection for such natural gas delivered during any month shall be the higher of—

(A) (i) the maximum price paid under the expired contract, per million Btu's, in the case of the month in which the effective date of such rollover contract occurs; and

(ii) in the case of any month thereafter, the maximum lawful price, per million Btu's, prescribed under this subparagraph for the preceding month multiplied by the monthly equivalent of the annual inflation adjustment factor applicable for such month; or

(B) (i) \$1.00 per million Btu's, in the case of April 1977; and

(ii) in the case of any month thereafter, the maximum lawful price, per million Btu's, prescribed under this subparagraph for the preceding month multiplied by the monthly equivalent of the annual inflation adjustment factor applicable for such month.

(2) CERTAIN STATE OR INDIAN PRODUCTION OR ROYALTY SHARES.—

(A) GENERAL RULE.—In the case of any first sale under any rollover contract of natural gas which was not committed or dedicated to interstate commerce on the day before the date of the enactment of this Act and which constitutes a

State government's or Indian tribes natural gas production, or royalty share or other interest (as of such day) in natural gas production, from real property (including subsurface mineral interest) owned on the date of the enactment of this Act by such State government or Indian tribe (as the case may be), the maximum lawful price under this subsection for any such natural gas delivered during any month shall be the maximum lawful price, per million Btu's, computed for such month under section 102 (relating to new natural gas).

(B) INDIAN TRIBAL LANDS.—For purposes of this paragraph, land shall be considered to be owned by an Indian tribe only if—

(i) such land is owned directly by such tribe; or

(ii) such land is held by the United States or any State in trust for Indian persons and is located within the boundaries of an Indian reservation (as such boundaries were in effect on the date of the enactment of this Act).

(C) DEFINITIONS.—For purposes of this paragraph—

(i) STATE GOVERNMENT.—The term "State government" means any State or any agency, instrumentality, or political subdivision of a State.

(ii) INDIAN TRIBE.—The term "Indian tribe" means any Indian tribe recognized as eligible for services provided by the Secretary of the Interior to Indians.

(c) CEILING PRICES MAY BE INCREASED IF JUST AND REASONABLE.—The Commission may, by rule or order,

prescribe a maximum lawful price, applicable to any first sale of any natural gas (or category thereof, as determined by the Commission) otherwise subject to the preceding provisions of this section, if such price is—

(1) higher than the maximum lawful price which would otherwise be applicable under such provisions; and

(2) just and reasonable within the meaning of the Natural Gas Act.

Sec. 107. Ceiling Price for High-Cost Natural Gas.

(a) WELLS COMPLETED BELOW 15,000 FEET.—In the case of any first sale of high-cost natural gas produced from any well the surface drilling of which began on or after February 19, 1977, if such production is from any completion location which is located at a depth of more than 15,000 feet, the maximum lawful price under this section for such natural gas delivered during any month shall be the maximum lawful price, per million Btu's, computed for such month under section 102 (relating to new natural gas).

(b) COMMISSION AUTHORITY TO PRESCRIBE HIGHER INCENTIVE PRICES.—The Commission may, by rule or order, prescribe a maximum lawful price, applicable to any first sale of any high-cost natural gas, which exceeds the otherwise applicable maximum lawful price to the extent that such special price is necessary to provide reasonable incentives for the production of such high-cost natural gas.

(c) DEFINITION OF HIGH-COST NATURAL GAS.—For purposes of this section, the term "high-cost natural gas" means natural gas determined in accordance with section 503 to be—

(1) produced from any well the surface drilling of which began on or after February 19, 1977, if such production is from a completion location which is located at a depth of more than 15,000 feet;

(2) produced from geopressured brine;

(3) occluded natural gas produced from coal seams;

(4) produced from Devonian shale; and

(5) produced under such other conditions as the Commission determines to present extraordinary risks or costs.

(d) PROVISIONS FOR HIGH-COST NATURAL GAS TO BE ELECTIVE.—If any credit, exemption, deduction, or comparable adjustment applicable ot the computation of any Federal tax is specifically allowable with respect to any high-cost natural gas (or category thereof) under any provision of law enacted after the date of the enactment of this Act, the provisions of subsections (a) and (b) of this section and the provisions of subtitle B shall not apply to such natural gas produced from any well unless an election to have such provisions apply (in lieu of such credit, exemption, deduction, or adjustment) with respect to such natural gas produced from such well is filed with the Commission on or before the later of—

(A) the 30th day after the date of the enactment of the Act under which such credit, exemption, deduction, or adjustment is provided; or

(B) the date the surface drilling of such well began.

Sec. 108. Ceiling Price for Stripper Well Natural Gas.

(a) GENERAL RULE.—In the case of any first sale of stripper well natural gas the maximum lawful price under this section for such natural gas delivered during any month shall be—

(1) $2.09 per million Btu's, in the case of May 1978; and

(2) in the case of any month thereafter, the maximum lawful price, per million Btu's, prescribed under this subsection for the preceding month multiplied by the monthly equivalent of a factor equal to the sum of—

(A) the annual inflation adjustment factor applicable for such month; plus

(B)(i) .035, in the case of any month beginning before April 20, 1981; or

(ii) .04, in the case of any month beginning after April 20, 1981.

(b) DEFINITION OF STRIPPER WELL NATURAL GAS.—

(1) GENERAL RULE.—Except as provided in paragraph (2), the term "stripper well natural gas" means natural gas determined in accordance with section 503 to be nonassociated natural gas produced during any month from a well if—

(A) during the preceding 90-day production period, such well produced nonassociated natural gas at a rate which did not exceed an average of 60 Mcf per production day during such period; and

(B) during such period such well produced at its maximum efficient rate of flow, determined in accordance with recognized conservation practices designed to maximize the ultimate recovery of natural gas.

(2) PRODUCTION IN EXCESS OF 60 MCF.—The Commission shall, by rule, provide that, if nonassociated natural gas produced from a well which previously qualified as a stripper well under paragraph (1) exceeds an average of 60 Mcf per production day during any 90-day production period, such natural gas may continue to qualify as stripper well natural gas if the increase in nonassociated natural gas produced from such well was the result of the application of recognized enhanced recovery techniques.

(3) Definitions.—For purposes of this subsection—

(A) Production day.—The term "production day" means—

(i) any day during which natural gas is produced; and

(ii) any day during which natural gas is not produced if production during such day is prohibited by a requirement of State law or a conservation practice recognized or approved by the State agency having regulatory jurisdiction over the production of natural gas.

(B) 90-day production period.—The term "90-day production period" means any period of 90 consecutive calendar days excluding any day during which natural gas is not produced for reasons other than voluntary action of any person with the right to control production of natural gas from such well.

(C) Nonassociated natural gas.—The term "nonassociated natural gas" means natural gas which is not produced in association with crude oil.

Sec. 109. Ceiling Price for Other Categories of Natural Gas.

(a) Application.—The maximum lawful price computed under subsection (b) shall apply to any first sale of any natural gas delivered during any month, in the case of any natural gas which is not covered by any maximum lawful price under any other section of this subtitle, including—

(1) natural gas produced from any new well not otherwise qualifying for a higher maximum lawful price under this title;

(2) natural gas committed or dedicated to interstate commerce on the day before the date of the enactment of this Act and for which a just and reasonable rate under the Natural Gas Act was not in effect on such date for the first sale of such natural gas;

(3) natural gas which was not committed or dedicated to interstate commerce on the day before the date of the enactment of this Act and which was not subject to an existing contract on such day; and

(4) natural gas produced from the Prudhoe Bay Unit of Alaska and transported through the natural gas transportation system approved under the Alaska Natural Gas Transportation Act of 1976.

(b) Maximum Lawful Price.—

(1) The maximum lawful price under this section for any month shall be—

(A) $1.45 per million Btu's, in the case of April 1977; and

(B) in the case of any month thereafter, the maximum lawful price, per million Btu's, prescribed under this paragraph for the preceding month multiplied by the monthly equivalent of the annual inflation adjustment factor applicable for such month.

(2) Ceiling prices may be increased if just and reasonable.—The Commission may, by rule or order, prescribe a maximum lawful ceiling price, applicable to any first sale of any natural gas (or category thereof, as determined by the Commission) otherwise subject to the preceding provisions of this section, if such price is—

(A) higher than the maximum lawful price which would otherwise be applicable under such provisions; and

(B) just and reasonable within the meaning of the Natural Gas Act.

Sec. 110. Treatment of State Severance Taxes and Certain Production-Related Costs.

(a) Allowance for State Severance Taxes and Certain Production-Related Costs.—Except as provided in subsection (b), a price for the first sale of natural gas shall not be considered to exceed the maximum lawful price applicable to the first sale of such natural gas under this subtitle if such first sale price exceeds the maximum lawful price to the extent necessary to recover—

(1) State severance taxes attributable to the production of such natural gas and borne by the seller, but only to the extent the amount of such taxes does not exceed the limitation of subsection (b); and

(2) any costs of compressing, gathering, processing, treating, liquefying, or transporting such natural gas, or other similar costs, borne by the seller and allowed for, by rule or order, by the Commission.

(b) Limitation on State Severance Taxes.—The State severance tax allowable under subsection (a)(1) with respect to the production of any natural gas may not include any amount of State severance taxes borne by the seller which results from a provision of State law enacted on or after December 1, 1977, unless such provision of law is equally applicable to natural gas produced in such State and delivered in interstate commerce and to natural gas produced in such State and not so delivered.

(c) Definition of State Severance Tax.—For purposes of this section, the term "State severance tax" means any severance, production, or similar tax, fee, or other levy imposed on the production of natural gas—

(1) by any State or Indian tribe (as defined in section 106(b)(2)(B)(ii)); and

(2) by any political subdivision of a State if the authority to impose such tax, fee, or other levy is granted to such political subdivision under State law.

Subtitle B—Decontrol of Certain Natural Gas Prices

Sec. 121. Elimination of Price Controls for Certain Natural Gas Sales.

(a) General Rule.—Subject to the reimposition of price controls as provided in section 122, the provisions of subtitle A respecting the maximum lawful price for the first sale of each of the following categories of natural gas shall, except as provided in subsections (d) and (e), cease to apply effective January 1, 1985:

(1) New natural gas.—New natural gas (as defined in section 102(c)).

(2) New, onshore production wells.—Natural gas produced from any new, onshore production well (as defined in section 103(c), if such natural gas—

(A) was not committed or dedicated to interstate commerce on April 20, 1977; and

(B) is produced from a completion location which is located at a depth of more than 5,000 feet.

(3) Intrastate contracts in excess of $1.00.—Natural gas sold under an existing contract, any successor to an existing contract, or any rollover contract, if—

(A) such natural gas was not committed or dedicated to interstate commerce on the day before the date of the enactment of this Act; and

(B) the price paid for the last deliveries of such natural gas occurring on December 31,

1984, or, if no deliveries occurred on such date, the price would have been paid had deliveries occurred on such date is higher than $1.00 per million Btu's.

(b) HIGH-COST NATURAL GAS.—Effective beginning on the effective date of the incremental price rule required under section 201, the provisions of subtitle A respecting the maximum lawful price for the first sale of natural gas shall cease to apply to the first sale of high-cost natural gas which is described in section 107(c) (1), (2), (3), or (4).

(c) NATURAL GAS PRODUCED FROM 5,000 OR LESS.—Effective beginning July 1, 1987, or, if later, the date of expiration of any price controls reimposed under section 122, the provisions of subtitle A respecting the maximum lawful price for any first sale of natural gas shall, except as provided in subsection (d), cease to apply to any first sale of natural gas produced from any new, onshore production well (as defined in section 103(c)), if such natural gas—

(1) was not committed or dedicated to interstate commerce on April 20, 1977; and

(2) is produced from a completion location which is located at a depth of 5,000 feet or less.

(d) EXCLUSION OF CERTAIN ALASKA NATURAL GAS.—The provisions of subsections (a) and (c) shall not apply to any natural gas produced from the Prudhoe Bay Unit of Alaska and transported through the natural gas transportation system approved under the Alaska Natural Gas Transportation Act of 1976.

(e) LIMITATION ON INDEFINITE PRICE ESCALATORS.—Natural gas which is not subject to maximum lawful prices under subtitle A solely by reason of subsection (a)(3) and which is sold under any existing contract or successor to an existing contract at a price established

under an indefinite price escalator clause (as defined in section 105(b)(3)(B)) shall be subject to the provisions of section 105(b)(3).

2. Section 503 of the Natural Gas Policy Act, as codified at 15 U.S.C. § 3413, provides:

Sec. 503. Determinations for Qualifying Under Certain Categories of Natural Gas.

(a) GENERAL RULE.—

(1) DETERMINATION.—If any State or Federal agency makes any final determination which it is authorized to make under subsection (c) for purposes of—

(A) applying the definition of new natural gas under section 102(c);

(B) deciding if certain natural gas produced from the Outer Continental Shelf qualifies under section 102(d) for the new natural gas ceiling price;

(C) applying the definition of new, onshore production well under section 103(c);

(D) applying the definition of high-cost natural gas under section 107(c); or

(E) applying the definition of stripper well natural gas under section 108(b);

such determination shall be applicable under this Act for such purposes unless such determination is reversed under the provisions of subsection (b) or unless such State or Federal agency has waived its authority under the provisions of subsection (c).

(2) NOTICE TO COMMISSION.—Any Federal or State agency making a determination under paragraph (1) shall provide timely notice in writing of such determination to the Commission. Such notice

shall include such substantiation and be in such a manner as the Commission may, by rule, require.

(b) COMMISSION REVIEW.—

(1) AUTHORITY TO REVIEW AND REVERSE.—The Commission shall reverse any final State or Federal agency determination described in subsection (a) if—

(A) it makes a finding that such determination is not supported by substantial evidence in the record upon which such determination was made; and

(B) such preliminary finding and notice thereof under paragraph (3) is made within 45 days after the date on which the Commission received notice of such determination under subsection (a)(2) and the final such finding is made within 120 days after the date of the preliminary finding.

(2) REMAND ON BASIS OF COMMISSION INFORMATION.—If—

(A) the Commission finds that a State or Federal agency determination is not consistent with information contained in the public records of the Commission, and which is not part of the record upon which such determination was made; and

(B) such preliminary finding and notice thereof under paragraph (3) is made within 45 days after the date on which the Commission received notice of such determination under subsection (a)(2) and the final such finding is made within 120 days after the date of the preliminary finding,

it may remand the matter to such State or Federal agency for consideration of such information. If

such agency, after consideration of the information transmitted to it by the Commission, affirms its previous determination, such determination, as so affirmed, shall be subject to review in accordance with this subsection (other than this paragraph).

(3) NOTICE.—The Commission shall provide notice of any proposed finding under this subsection to the State or Federal agency which made such determination and those parties identified in the notice to the Commission of such determination.

(4) JUDICIAL REVIEW OF COMMISSION ACTIONS.—

(A) REMANDS.—Any party identified in the notice to the Commission of a determination by a State or Federal agency may obtain review of any final decision by the Commission to remand under paragraph (2) in the United States Court of Appeals for any circuit in which such party is located or has its principal place of business, or in the United States Court of Appeals for the District of Columbia circuit. The reviewing court shall reverse any such decision if it finds such decision is arbitrary or capricious.

(B) FINDINGS.—Any person aggrieved or adversely affected by a final finding of the Commisison under paragraph (1) may within 60 days thereafter file a petition for review of such finding in the United States Court of Appeals for any circuit in which the party involved in such determination is located or has its principal place of business, or in the United States Court of Appeals for the District of Columbia circuit. The reviewing court shall reverse any such finding of the Commission if the State or Federal agency determination involved is supported by substantial evidence.

(c) STATE AUTHORITY.—

(1) GENERAL RULE.—A Federal or State agency having regulatory jurisdiction with respect to the production of natural gas is authorized to make determinations referred to in subsection (a).

(2) WAIVER.—

(A) IN GENERAL.—Any Federal or State agency may, in whole or in part, waive its authority to make determinations referred to in subsection (a)(1) by entering into an agreement in accordance with subparagraph (B). If such agency executes such a waiver, the Commission shall, consistent with the agreement, make the determinations which would otherwise be made by such Federal or State agency until the earlier of—

(i) the expiration of the period specified in the agreement; or

(ii) the date such agency transmits to the Commission written notice that it terminates such waiver and assumes the authority to make determinations referred to in subsection (a)(1).

Any waiver, or termination of any waiver, shall not apply to any determination with respect to any petition therefor which is pending before such agency or the Commission (as the case may be) on the date on which such a waiver or revocation is made.

(B) AGREEMENTS.—Any waiver under subparagraph (A) may be made only by a written agreement between the Federal or State agency involved and the Commisison. Any such agreement shall set forth the terms and conditions applicable to such waiver.

(3) PROCEDURES APPLICABLE.—Determinations of a Federal or State agency referred to in subsection (a)(1) shall be made in accordance with the procedures generally applicable to such agency for the making of such determinations or comparable determinations under the provisions of Federal or State law, as the case may be, pursuant to which they exercise their regulatory jurisdiction. The Commission may prescribe the form and content of filings with a Federal or State agency in connection with determinations made under this section.

(4) JUDICIAL REVIEW.—Any such determination referred to in subsection (a)(1) made in accordance with procedures described in paragraph (3) shall not be subject to judicial review under any Federal or State law except as provided under subsection (b).

(d) EFFECT OF DETERMINATIONS.—For purposes of this Act—

(1) GENERAL RULE.—Any final determination referred to in subsection (a)(1) made by a Federal or State agency (or by the Commission under subsection (c)(2)) which relates to any natural gas and which is no longer subject to review by the Commission under this section or to judicial review shall thereafter be binding with respect to such natural gas. The preceding sentence shall not apply to any final determination—

(A) if in making such determination the Commission or such Federal or State agency relied on any untrue statement of a material fact; or

(B) if there was omitted a statement of material fact necessary in order to make the statements made not misleading, in light of the circumstances under which they were made, to the

Federal or State agency in making such final determination or to the Commission in reviewing such determination.

(2) APPLICATION OF TITLE 18.—Any untrue statement or omission of material fact to a Federal or State agency upon which the Commission relied shall be deemed to be statement or entry under section 1001 of title 18, United States Code.

(e) INTERIM COLLECTION OF MAXIMUM LAWFUL PRICE.—

(1) COLLECTION OF SECTION 109 PRICE.—

(A) GENERAL RULE.—Effective beginning on the first day of the first month beginning after the date of the enactment of this Act, a seller of natural gas which is produced from a new well may, in accordance with subparagraph (B), charge and collect the appropriate maximum lawful price under section 109 for any first sale of such natural gas.

(B) REQUIREMENTS.—A seller may charge and make collections under subparagraph (A) only in accordance with the following requirements:

(i) SWORN STATEMENT.—Before any such collection is made, the seller shall file with the Commission, and any Federal or State agency having authority to make determinations referred to in subsection (a)(1), a written sworn statement that such natural gas is produced from a new well and that such seller believes in good faith that such natural gas is eligible under this Act to be sold at a price not less than the appropriate maximum lawful price under section 109.

(ii) PETITION FOR DETERMINATION.—Within 90 days after the date of the enactment of this Act, the seller files a petition to such Federal or State agency for a determination under this section.

(iii) COLLECTION SUBJECT TO REFUND.—Any such collection made by the seller pending a determination under this section shall be collected subject to a condition of refund, with interest, in the event it is determined by such Federal or State agency that the applicable maximum lawful price is lower than that provided under section 109.

(2) ALTERNATE INTERIM COLLECTION AUTHORITY.—

(A) GENERAL RULE.—Promptly after the date of the enactment of this Act, the Commission shall, by rule or order, provide one or more methods under which a seller of natural gas may, in accordance with requirements established, and for such period as may be prescribed, under such rule or order, charge and collect for any first sale of such natural gas the maximum lawful price under title I for which a petition is filed for a determination under this section in any case in which such price exceeds the appropriate maximum lawful price under section 109.

(B) COLLECTION SUBJECT TO REFUND.—Any such collection made by the seller pending a determination under section 503 shall be collected subject to a condition of refund, with interest. Such refund with interest shall be paid, in accordance with the rule under subparagraph (A), unless it is determined under this Act that the applicable maximum lawful price is equal to or greater than that collected. In addition, such

seller shall comply with such requirements as the Commission shall prescribe in the applicable rule or order to provide adequate assurance that funds, to the extent attributable to a price in excess of the appropriate maximum lawful price under title I are available in the event of such refund.

(3) COLLECTION AFTER INITIAL DETERMINATION.—

(A) GENERAL RULE.—Effective beginning on the date of the notice of a determination under subsection (a)(2), a seller of natural gas covered by such determination may, in accordance with subparagraph (B), charge and collect the appropriate maximum lawful price applicable under such determination.

(B) REQUIREMENTS.—A seller may charge and make collections under subparagraph (A) if such collection is subject to conditions prescribed by the Commission to assure refund, with interest, in the event it is determined under this Act that the applicable maximum lawful price is lower than that provided under section 109.

3. Section 601 of the Natural Gas Policy Act, as codified at 15 U.S.C. § 3431, provides:

Sec. 601. Coordination with the Natural Gas Act.

(a) JURISDICTION OF THE COMMISSION UNDER THE NATURAL GAS ACT.—

(1) SALES.—

(A) NATURAL GAS NOT COMMITTED OR DEDICATED.—For purposes of section 1(b) of the Natural Gas Act, effective on the first day of the

first month beginning after the date of the enactment of this Act, the provisions of the Natural Gas Act and the jurisdiction of the Commission under such Act shall not apply to natural gas which was not committed or dedicated to interstate commerce as of the day before the date of enactment of this Act solely by reason of any first sale of such natural gas.

(B) COMMITTED OR DEDICATED NATURAL GAS.—Effective beginning on the first day of the first month beginning after the date of the enactment of this Act, for purposes of section 1(b) of the Natural Gas Act, the provisions of such Act and the jurisdiction of the Commission under such Act shall not apply solely by reason of any first sale of natural gas which is committed or dedicated to interstate commerce as of the day before the date of the enactment of this Act and which is—

(i) high-cost natural gas (as defined in section 107(c) (1), (2), (3), or (4) of this Act);

(ii) new natural gas (as defined in section 102(c) of this Act); or

(iii) natural gas produced from any new, onshore production well (as defined in section 103(c) of this Act).

(C) AUTHORIZED SALES OR ASSIGNMENTS.—For purposes of section 1(b) of the Natural Gas Act, the provisions of the Natural Gas Act and the jurisdiction of the Commission under such Act shall not apply by reason of any sale of natural gas—

(i) authorized under section 302(a) or 311(b); or

(ii) pursuant to any assigned authorized under section 312(a).

(D) NATURAL-GAS COMPANY.—For purposes of the Natural Gas Act, the term "natural-gas company" (as defined in section 2(6) of such Act) shall not include any person by reason of, or with respect to, any sale of natural gas if the provisions of the Natural Gas Act and the jurisdiction of the Commission do not apply to such sale solely by reason of subparagraph (A), (B), or (C) of this paragraph.

(E) ALASKAN NATURAL GAS.—Subparagraph (B) (ii) and (iii) shall not apply with respect to natural gas produced from the Prudhoe Bay unit of Alaska and transported through the transportation system approved under the Alaska Natural Gas Transportation Act of 1976.

(2) TRANSPORTATION.—

(A) JURISDICTION OF THE COMMISSION.—For purposes of section 1(b) of the Natural Gas Act the provisions of such Act and the jurisdiction of the Commission under such Act shall not apply to any transportation in interstate commerce of natural gas if such transportation is—

(i) pursuant to any order under section 302(c) or section 303 (b), (c), (d), or (h) of this Act; or

(ii) authorized by the Commission under section 311(a) of this Act.

(B) NATURAL-GAS COMPANY.—For purposes of the Natural Gas Act, the term "natural-gas company" (as defined in section 2(6) of such Act) shall not include any person by reason of, or with respect to, any transportation of natural gas if the provisions of the Natural Gas Act and the jurisdiction of the Commission under the Natural Gas Act do not apply to such transportation by reason of subparagraph (A) of this paragraph.

(b) CHARGES DEEMED JUST AND REASONABLE.—

(1) SALES.—

(A) FIRST SALES.—Subject to paragraph (4), for purposes of sections 4 and 5 of the Natural Gas Act, any amount paid in any first sale of natural gas shall be deemed to be just and reasonable if—

(i) such amount does not exceed the applicable maximum lawful price established under title I of this Act; or

(ii) there is no applicable maximum lawful price solely by reason of the elimination of price controls pursuant to subtitle B of title I of this Act.

(B) EMERGENCY SALES.—For purposes of sections 4 and 5 of the Natural Gas Act, any amount paid in any sale authorized under section 302(a) shall be deemed to be just and reasonable if such amount does not exceed the fair and equitable price established under such section and applicable to such sale.

(C) SALES BY INTRASTATE PIPELINES.—For purposes of section 4 and 5 of the Natural Gas Act, any amount paid in any sale authorized by the Commission under section 311(b) shall be deemed to be just and reasonable if such amount does not exceed the fair and equitable price established by the Commission and applicable to such sale.

(D) ASSIGNMENTS.—For purposes of sections 4 and 5 of the Natual Gas Act, any amount paid pursuant to the terms of any contract with respect to that portion of which the Commission has authorized an assignment authorized under section 312(a) shall be deemed to be just and reasonable if such amount does not exceed the applicable maximum lawful price established under title I of this Act.

(E) AFFILIATED ENTITIES LIMITATION.—For purposes of paragraph (1), in the case of any first sale between any interstate pipeline and any affiliate of such pipeline, any amount paid in any first sale shall be deemed to be just and reasonable if, in addition to saitsfying the requirements of such paragraph, such amount does not exceed the amount paid in comparable first sales between persons not affiliated with such interstate pipeline.

(2) OTHER CHARGES.—

(A) ALLOCATION.—For purposes of sections 4 and 5 of the Natural Gas Act, any amount paid by any interstate pipeline for transportation, storage, delivery or other services provided pursuant to any order under section 303 (b), (c), or (d) of this Act shall be deemed to be just and reasonable if such amount is prescribed by the President under section 303(h)(1).

(B) TRANSPORTATION.—For purposes of sections 4 and 5 of the Natural Gas Act, any amount paid by any interstate pipeline for any transportation authorized by the Commission under section 311(a) of this Act shall be deemed to be just and reasonable if such amount does not exceed that approved by the Commission under such section.

(c) GUARANTEED PASSTHROUGH.—

(1) CERTIFICATE MAY NOT BE DENIED BASED UPON PRICE.—The Commission may not deny, or condition the grant of, any certificate under section 7 of the Natural Gas Act based upon the amount paid in any sale of natural gas, if such amount is deemed to be just and reasonable under subsection (b) of this section.

(2) RECOVERY OF JUST AND REASONABLE PRICES PAID.—For purposes of sections 4 and 5 of the Natural Gas Act, the Commission may not deny any interstate pipeline recovery of any amount paid with respect to any purchase of natural gas if—

(A) under subsection (b) of this section, such amount is deemed to be just and reasonable for purposes of sections 4 and 5 of such Act, and

(B) such recovery is not inconsistent with any requirement of any rule under section 201 (including any amendment under section 202),

except to the extent the Commission determines that the amount paid was excessive due to fraud, abuse, or similar grounds.

4. Section 4 of the Natural Gas Act of 1938, as amended and codified at 15 U.S.C. § 717c, provides:

§ 717c. Rates and charges

(a) Just and reasonable rates and charges. All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.

(b) Undue preferences and unreasonable rates and charges prohibited. No natural-gas company shall, with respect to any transportation or sale of natural gas subject to the jurisdiction of the Commission, (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service.

(c) Filing of rates and charges with Commission; public inspection of schedules. Under such rules and regulations as the Commission may prescribe, every natural-gas company shall file with the Commission, within such time (not less than sixty days from the date this Act takes effect) and in such form as the Commission may designate, and shall keep open in convenient form and place for public inspection, schedules showing all rates and charges for any transportation or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services.

(d) Changes in rates and charges; notice to Commission. Unless the Commission otherwise orders, no change shall be made by any natural-gas company in any such rate, charge, classification, or service, or in any rule, regulation, or contract relating thereto, except after thirty days' notice to the Commission and to the public. Such notice shall be given by filing with the Commission and keeping open for public inspection new schedules stating plainly the change or changes to be made in the schedule or schedules then in force and the time when the change or changes will go into effect. The Commission, for good cause shown, may allow changes to take effect without requiring the thirty days' notice herein provided for by

an order specifying the changes so to be made and the time when they shall take effect and the manner in which they shall be filed and published.

(e) Authority of Commission to hold hearings concerning new schedule of rates. Whenever any such new schedule is filed the Commission shall have authority, either upon complaint of any State, municipality, State commission, or gas distributing company, or upon its own initiative without complaint, at once, and if it so orders, without answer or formal pleading by the natural-gas company, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the natural-gas company affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect; and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of the suspension period, on motion of the natural-gas company making the filing, the proposed change of rate, charge, classification, or service shall go into effect. Where increased rates or charges are thus made effective, the Commission may, by order, require the natural-gas company to furnish a bond, to be approved by the Commission, to refund any amounts ordered by the Commission, to keep accurate accounts in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts were paid, and, upon completion of the hearing and decision, to order such natural-gas company to refund, with interest, the por-

tion of such increased rates or charges by its decision found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the natural-gas company, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible.

(June 21, 1938, ch 556, § 4, 52 Stat. 822; May 21, 1962, P. L. 87-454, 76 Stat. 72.)

5. Section 7(c) of the Natural Gas Act of 1938, as amended and codified at 15 U.S.C. § 717f(c), provides:

(c) Certificate of public convenience and necessity. (1) (A) No natural-gas company or person which will be a natural-gas company upon completion of any proposed construction or extension shall engage in the transportation or sale of natural gas, subject to the jurisdiction of the Commission, or undertake the construction or extension of any facilities therefor, or acquire or operate any such facilities or extensions thereof, unless there is in force with respect to such natural-gas company a certificate of public convenience and necessity issued by the Commission authorizing such acts or operations: Provided, however, That if any such natural-gas company or predecessor in interest was bona fide engaged in transportation or sale of natural gas, subject to the jurisdiction of the Commission, on the effective date of this amendatory Act, over the route or routes or within the area for which application is made and has so operated since that time, the Commission shall issue such certificate without requiring further proof that public convenience and necessity will be served by such operation, and without further proceedings, if application for such certificate is made to the Commission within ninety days after the effective date of this amendatory Act. Pending the determination of any such application, the continuance of such operation shall be lawful.

(B) In all other cases the Commission shall set the matter for hearing and shall give such reasonable notice of the hearing thereon to all interested persons as in its judgment may be necessary under rules and regulations to be prescribed by the Commission; and the application shall be decided in accordance with the procedure provided in subsection (e) of this section and such certificate shall be issued or denied accordingly: Provided, however, That the Commission may issue a temporary certificate in cases of emergency, to assure maintenance of adequate service or to serve particular customers, without notice or hearing, pending the determination of an application for a certificate, and may by regulation exempt from the requirements of this section temporary acts or operations for which the issuance of a certificate will not be required in the public interest.

(2) The Commission may issue a certificate of public convenience and necessity to a natural-gas company for the transportation in interstate commerce of natural gas used by any person for one or more high-priority uses, as defined, by rule, by the Commission, in the case of—

(A) natural gas sold by the producer to such person; and

(B) natural gas produced by such person.

APPENDIX B

ORDER NO. 451 INCREASES IN THE VINTAGED CEILING PRICES THAT CONGRESS ESTABLISHED FOR FLOWING OLD GAS AS OF DECEMBER, 1986 (WHEN ORDER NO. 451-A ISSUED)

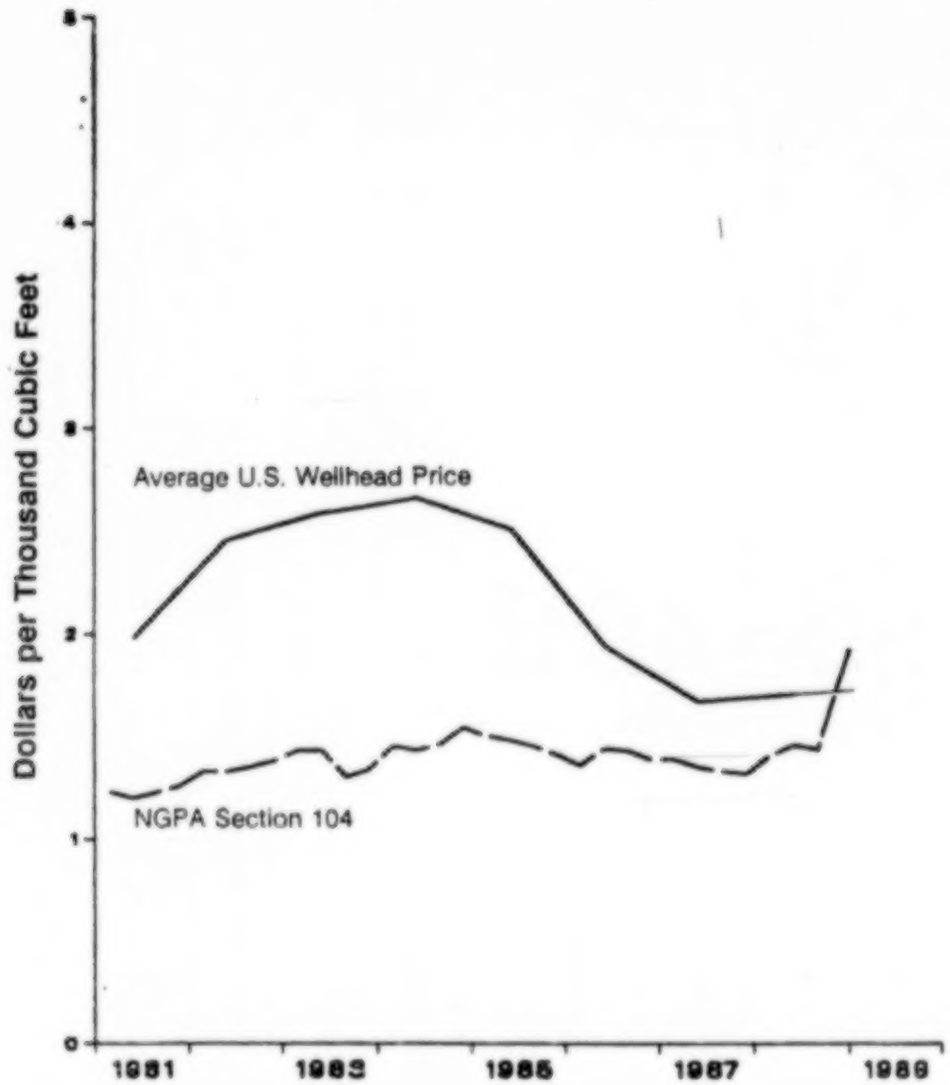
Old Gas Vintages	Congressionally Mandated Ceiling Prices for Section 104 and Section 106(a) Gas	Order No. 451 Ceiling Price	Increase Worked by Order No. 451	
	Per MMBtu	Per MMBtu	Dollars	%
Post-1974 Gas-				
All Producers	$2.609	$2.609	0	0
1973-1974 Biennium Gas				
Small Producers	$2.206	$2.609	$0.403	18.3%
Large Producers	$1.685	$2.609	$0.924	54.8%
Interstate Roll-over Gas	$0.970	$2.609	$1.639	168.9%
Replacement contract gas				
Small Producers	$1.237	$2.609	$1.372	110.9%
Large Producers	$0.951	$2.609	$1.658	174.3%
Flowing Gas				
Small Producers	$0.627	$2.609	$1.980	316.1%
Large Producers	$0.527	$2.609	$2.082	395.0%

Old Gas Vintages	Congressionally Mandated Ceiling Prices for Section 104 and Section 106(a) Gas	Order No. 451 Ceiling Price	Increase Worked by Order No. 451	
	Per MMBtu	Per MMBtu	Dollars	%
Certain Permian Basin Gas				
Small Producers	$0.737	$2.609	$1.872	254.0%
Large Producers	$0.653	$2.609	$1.956	299.5%
Certain Rocky Mountain Gas				
Small Producers	$0.737	$2.609	$1.872	254.0%
Large Producers	$0.627	$2.609	$1.982	316.1%
Certain Appalachian Gas				
With North Subarea Contracts	$0.596	$2.609	$2.013	337.7%
Other Contracts	$0.551	$2.609	$2.058	373.5%
Minimum Rate Cas [1]				
All Producers	$0.327	$2.609	$2.282	697.8%

[1] Prices for minimum rate gas are expressed in terms of dollars per Mcf, rather than MMBtu. This table assumes a 1:1 conversion from Mcf to MMBtu for minimum rate gas.

APPENDIX C

Average U.S. Wellhead Prices Compared to Section 104 Prices. 1981-1988



Sources: EIA, *Natural Gas Monthly.*

Natural Gas Price Controls: Hearing on H.R. 1595 before the House Comm. on Energy and Commerce, 101st Cong., 1st Sess. 27 (1989) (attachment to testimony of J. Allen Wampler, Assistant Secretary for Fossil Energy, U.S. Department of Energy).

(11) (11)

Nos. 89-1452, 89-1453

IN THE
Supreme Court of the United States

OCTOBER TERM, 1990

MOBIL OIL EXPLORATION & PRODUCING SOUTHEAST, INC., *et al.*,
Petitioners,
v.
UNITED DISTRIBUTION COMPANIES, *et al.*,
Respondents.

FEDERAL ENERGY REGULATORY COMMISSION,
Petitioners,
v.
UNITED DISTRIBUTION COMPANIES, *et al.*,
Respondents.

On Writs of Certiorari to the United States Court of Appeals for the Fifth Circuit

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REPLY BRIEF OF PETITIONERS IN NO. 89-1452

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REPLY BRIEF OF PETITIONERS IN NO. 89-1452

Aside from a few, almost perfunctory, legal points, respondents' submission is merely an extended policy argument for overturning Order 451—an argument that would be better addressed to Congress or the Federal Energy Regulatory Commission ("FERC") rather than this Court. Respondents ask this Court to ignore the express language of Sections 104 and 106 of the NGPA (which respondents never even bother to quote or discuss) as well as Section 7(b) of the NGA. They would also have this Court ignore well-settled principles of statutory interpretation embodied in such decisions as *Chevron USA* v. *NRDC*, 467 U.S. 837 (1984). And perhaps most striking, they would have this Court ignore the central and prescient policy judgment on which Order 451 was based: that, regardless of its effect on wholesale prices for *old* gas (which are not paid by residential consumers at all, see p. 4, *infra*), Order 451 would lead, on average, to a reduction in the only prices that ultimately matter—"burnertip" prices actually paid by natural gas users.

What makes respondents' policy arguments particularly unsatisfactory is that they not only are irrelevant to the legal issues before this Court, but they are also patently incorrect. And, to the extent respondents advance arguments that are germane to the three issues presented in this case—pricing, abandonment and take-or-pay—those arguments cast no doubt on the FERC's authority to adopt Order 451.

I. RESPONDENTS' ASSERTIONS ABOUT THE "DEREGULATORY" EFFECTS OF ORDER 451, ITS ADVERSE EFFECTS UPON CONSUMERS, AND THE INTERESTS OF THE PARTIES IN THIS CASE ARE INCORRECT.

Three policy arguments pervade respondents' brief: (1) the Commission, in Order 451, was trying surreptitiously to dismantle what remained of natural gas reg-

ulation after the NGPA; (2) the overall effect of Order 451 was to harm natural gas consumers; and (3) this Court should give weight to respondents' views on these matters because respondents, rather than the FERC, represent the interests of gas consumers generally. Each of these assertions is groundless.

A. Order 451 did not "deregulate" old gas in any sense. Today, the FERC regulations applicable to old gas span some 230 pages of the Code of Federal Regulations, 27 pages *more* than before Order 451 was adopted. Compare 18 C.F.R. Parts 154, 157, 270, 271 (1990), with 18 C.F.R. Parts 154, 157, 270, 271 (1985).

Even more important, all old gas (except that deregulated under the Wellhead Decontrol Act) is still subject to a ceiling price—established in Order 451—that is cost-based and not, as respondents suggest (Resp. Br. 19-20, 29, 41, 48, 49, 55), based upon "market" prices. See Producers Br. 8-10, 21-23.[1] The ceiling price chosen by the Commission was not simply pulled from thin air, as respondents would have this Court believe.

Because it is a ceiling price, moreover, old gas cannot be priced above it, regardless of what happens to the market price. Thus, that ceiling protects consumers by preventing any natural gas producer from substantially increasing its prices if some unexpected event (like war in the Middle East) or market condition (like a substantial decrease in available supplies) causes a significant increase in the spot market price. Moreover, Order 451 leaves intact the Commission's traditional authority to modify the ceiling price structure further if necessary to protect consumers. See Producers Br. 24.

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[1] As used by the Commission, "replacement cost" is the cost of finding new gas fields, drilling new wells and producing new gas. See J.A. 75, 237-38. It is *not*, as respondents' arguments assume, the cost of "replacing" one source of supply with another source of supply on the spot market. The cost studies on which the FERC relied in setting the ceiling price in Order 451 were studies of actual costs, not market prices. See J.A. 233-34.

Respondents' assertion (Resp. Br. 25, 58) that gas "released" under Order 451 is not subject to further certificate or abandonment regulation is equally groundless. Even as to that gas, Commission regulations continue to specify the circumstances under which a producer may and may not abandon sales to a customer. See 18 C.F.R. § 157.301. Moreover, although the Commission does not require the filing of abandonment and certificate applications each time a producer agrees to sell its gas to a different customer, anyone aggrieved by such a decision can file a complaint with the Commission. See *infra* note 15.[2] Under Section 7(b) of the NGA, the Commission retains full authority (a) to invalidate any particular abandonment found to be unlawful, and (b) to change its abandonment and certificate requirements if it believes such a change would be in the public interest.

Respondents' new argument (Resp. Br. 23, 54) that Order 451 violates the filed rate doctrine by relieving sellers of released gas of their usual tariff filing obligations is similarly meritless. Section 157.301(c) of the Commission's regulations requires those sellers to comply with the NGA's tariff-filing requirements in the same way that sellers in other regulated industries are required to comply with similar statutory requirements—by filing summaries of their contracts. See, *e.g.*, *Sea-Land Serv. Co.* v. *ICC*, 738 F.2d 1311, 1316-19 (D.C. Cir. 1984) (holding that this practice satisfies tariff-filing requirement).[3]

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[2] This "blanket" certificate and abandonment procedure no more constitutes "deregulation" than similar procedures adopted by the Commission—and uniformly approved by the courts—in other contexts. Such procedures have often permitted pipelines (including the pipelines that are respondents in this case), as well as producers, to abandon service to one customer and institute service to another without obtaining specific Commission approval. *E.g.*, *Kansas Power & Light Co.* v. *FERC*, 851 F.2d 1479, 1482-86 (D.C. Cir. 1988); *Williams Natural Gas Co.*, 51 F.E.R.C. ¶ 62,234 (1990); *Columbia Gas Transmission Corp.*, 33 F.E.R.C. ¶ 61,407 (1986).

[3] For this reason, respondents' claim that the tariff-filing features of Order 451 are contrary to Section 4(b) of the NGA—a claim

In any case, respondents' obsession with "deregulation" does not advance the analysis. "Deregulation" is a label, not a rule of decision. Regardless of how one characterizes Order 451, the only relevant question is whether each of its elements is within the Commission's authority under the NGA and the NGPA. To attempt to resolve this case under respondents' standardless "deregulation" theory would be to undertake the kind of policy determination to which Congress and the FERC are best suited.

B. Respondents' assertion that Order 451 has harmed consumers is also patently false. Respondents do not and cannot dispute that average residential retail prices for natural gas have declined in real terms by approximately 15 percent in the three years since Order 451 went into effect. See Producers Br. 8 n. 3; see also Appendix A, *infra*. Rather, respondents repeatedly suggest (Resp. Br. 2, 20-21, 36-37, 42) that consumers have somehow been made worse off by Order 451 because prices for *old* gas alone have allegedly increased since Order 451.

Residential customers, however, do not buy "old" gas per se. Under the "rolled-in" system of natural gas pricing, consumers buy whatever mix of old and new gas has been purchased at wholesale by a particular pipeline and resold to the customer's "local distribution company." See, *e.g.*, *Laclede Gas Co.* v. *FERC*, 722 F.2d 272, 274 (5th Cir. 1984) (describing rolled-in pricing). From a customer's perspective, the only relevant price is the retail price it pays for that mix of gas. On average, that price has declined substantially since Order 451 went into effect, just as the FERC predicted it would. Respondents' statistics (Resp. Br. 2 & App. B & C) are therefore as irrelevant as they are misleading.

C. To be sure, *some* groups of consumers—including most of the consumer groups represented before this

respondents never raised before the FERC or the court below—is groundless. Cf. *Maislin Indus., U.S.* v. *Primary Steel, Inc.*, 110 S. Ct. 2759 (1990).

Court (see Resp. Br. 71-72)—were made worse off by Order 451, just as the FERC predicted. See J.A. 277, 285, 305. But those were the very customers that the FERC (as well as the Secretary of Energy) found had historically benefitted, at the expense of the American public generally, from the "gargantuan inequity" and geographic disparities inherent in the preexisting old gas pricing regime. J.A. 77 n. 155, 247.

Respondents' suggestions (Resp. Br. 21, 36-37) that they, rather than the FERC, represent the interests of the gas-consuming public generally are therefore preposterous. The FERC is the only party before this Court with the statutory duty and expertise, based on more than 50 years' experience in the industry, to represent the interests of *all* gas consumers.[4] To the extent there is any relevant dispute about the actual effects of Order 451 on consumers, the FERC's judgment—which is amply supported by the only relevant data (see *supra* p. 4)—must control.

II. THE PRICING ASPECTS OF ORDER 451 ARE WELL WITHIN THE FERC'S AUTHORITY.

According to respondents, the root error of Order 451 is that it "collaps[ed] the vintage prices of all categories

[4] Contrary to respondents' efforts to impugn the private petitioners' motives (Resp. Br. 13, 37), natural gas producers have three interests in this case, all of which happen to coincide with the interests of the gas consuming public. *First*, as the Commission predicted, Order 451 has substantially increased the supplies of old gas available to the market. Although this increase in supply has decreased average wellhead prices (see Producer Br. 8 n. 3; Appendix B, *infra*), it has also meant increased sales as well as a longer useful life for existing wells. *Second*, Order 451 has advanced producers' long-term interest in ensuring that natural gas is an attractive and reliable alternative to other energy sources such as coal and electricity. It has done so, for example, by increasing the mobility of natural gas supplies and by fostering producer-pipeline settlements, as well as by reducing prices. *Third*, natural gas producers have a strong interest in avoiding the uncertainty and litigation that likely would accompany the vacatur of Order 451. See Petition for Certiorari in No. 89-1452 at 26-28; Reply Brief in Support of Petition for Certiorari in No. 89-1452 at 1-2.

of old gas into a single price equal to the highest vintage price." Resp. Br. 29. This assertion presents two distinct issues, which respondents sometimes confuse: (1) whether the Commission has the authority to set a single ceiling price for all categories of old gas, thereby collapsing vintage pricing of old gas; and (2) whether the ceiling price the Commission chose satisfies the "just and reasonable" standard of the NGA and the NGPA. The FERC's resolution of both issues is well within its authority.

A. Authority To Set A Single Ceiling Price

Respondents do not dispute that the plain language of Sections 104(b)(2) and 106(c) of the NGPA permits the Commission to set the ceiling price applicable to each vintage of old gas at the same level, and thereby effectively to collapse the vintage pricing system. See FERC Br. 24-30, Producers Br. 18-23. Instead, respondents contend that this language simply cannot mean what it says. They advance three reasons, each of which misses the mark.

First, respondents claim that "the structure and purpose of the statute as a whole" (Resp. Br. 29)—as well as the NGPA's legislative history—override the plain language of Sections 104(b)(2) and 106(c) by demonstrating a congressional intent to preserve the vintage pricing structure for old gas while deregulating new gas. Resp. Br. 33-37, 41-43. But that argument confuses two distinct questions as well as the distinct statutory provisions that address them: (a) what kind of pricing scheme for old gas did Congress itself incorporate, as a starting point, into the NGPA; and (b) to what extent did Congress authorize the FERC to alter that pricing scheme in response to changing conditions?

The answer to the first question is that Congress, without any critical review of the FERC's existing vintage pricing system, simply carried that system forward in the NGPA. That answer is not disputed. It is clearly spelled out in Subsections 104(b)(1) and 106(a) & (b) (not Subsections 104(b)(2) and 106(c), the provisions

on which the FERC relied here). It is also confirmed by the structural and historical evidence cited by respondents.

But the answer to the second question cannot be found in Subsections 104(b)(1) and 106(a) & (b), or in respondents' structural and historical materials, which merely describe what Congress was doing in *those* provisions. None of those sources purports to address the scope of the Commission's authority to modify the pricing structure carried forward in the NGPA. Instead, *that* question is squarely answered by the parallel provisions of Sections 104 and 106—*i.e.*, Subsections 104(b)(2) and 106(c)—which respondents neither quote nor analyze.

As explained in petitioners' opening briefs (FERC Br. 30, Producers Br. 18-19), the latter provisions expressly grant the FERC complete authority, "by rule or order" to increase the ceiling price applicable to "any . . . category" of old gas as long as the new price satisfies the "just and reasonable" standard of the NGA. If the Commission (as it is permitted to do) exercises this authority with respect to several categories of old gas simultaneously, and if the Commission (as it is also permitted to do) raises the ceiling price for all categories so affected to the same level, the natural consequence is to eliminate or "collapse" the pricing distinctions among the categories of old gas so affected. See Producers Br. 18-20. Moreover, because all of the vintage categories of old gas were originally created by the Commission itself under the broad "just and reasonable" standard, it stands to reason that, by putting the same standard in Sections 104(b)(2) and 106(c), Congress meant to permit the Commission to collapse some or all of those price categories if it determined that the distinctions among them no longer produced just and reasonable results. See Producers Br. 20-23. In short, the statutory language gives the Commission ample authority to collapse the "vintaged" price distinctions among the various cate-

gories of old gas. See FERC Br. 30 & n. 12, Producers Br. 18-20.[5]

The breadth of Sections 104(b)(2) and 106(c) is also confirmed by the structural and historical evidence cited by petitioners (see FERC Br. 36-38, Producers Br. 27-32), most of which is not even addressed in respondents' brief. One such piece of evidence is the fact that Congress enacted a separate provision—Section 502(c)—to deal with the very problem of "special relief" which respondents now claim (Resp. Br. 38-41) was the sole focus of Sections 104(b)(2) and 106(c). Respondents, therefore, devote a great deal of effort to developing an interpretation of those provisions that would render them superfluous. See Producers Br. 18 n. 5.

In sum, only the Commission's interpretation of its ratemaking authority is consistent with all of the pertinent interpretive materials and therefore best reflects the structure and purpose of the "statute as a whole." Respondents' interpretation, by contrast, would require this Court to ignore a great deal of structural and historical evidence as well as the plain statutory language. Taken together, that evidence demonstrates that the true "compromise" embodied in the NGPA was not, as respondents would have it (Resp. Br. 29, 34-35, 36, 42, 44-45), to deregulate new gas while etching in stone the Commission's existing vintage pricing structure for old gas.[6] Rather, the compromise was to deregulate new gas and retain the pre-existing vintage pricing structure for old

[5] As petitioners pointed out in their opening briefs (FERC Br. 12, Producers Br. 8), Order 451 did *not* collapse the only vintaging relationships mandated by the NGPA itself, *i.e.*, the price distinctions *between* old gas and the various categories of new gas.

[6] Indeed, the implausibility of respondents' position is demonstrated by the patchwork quality of the vintage pricing system as it existed in 1978. Six of the 16 pre-Order 451 categories were based primarily upon the size of the producer. Four others were based solely upon the location of the well. See 18 C.F.R. § 271.101 (1985). Congress simply could not have intended to preserve such arbitrary distinctions forever.

gas *until* the FERC determined that a modification of that structure was just and reasonable. See FERC Br. 37-38.

Second, implicitly conceding that nothing in the language, structure or legislative history of the NGPA specifically *precludes* the FERC from modifying substantially the basic pricing structure embodied as a starting point in Sections 104(b)(1) and 106(a) & (b), respondents make a lame attempt to turn that fact to their advantage. Noting that Sections 104(b)(2) and 106(c) were "added with no debate at the very end of the legislative process" (Resp. Br. 33), respondents contend it is "inconceivable" that Congress would grant the Commission such authority "without providing some description and explanation of what it was doing." Resp. Br. 56. But this argument overlooks the crucial fact that the *entire* compromise embodied in the NGPA was drafted in conference, at the end of the legislative process, and with little debate. See Note, *Legislative History of the Natural Gas Policy Act*, 59 Tex. L. Rev. 101, 114-116 (1980). It also ignores the fact that, aside from forbidding the FERC to reduce any ceiling price, Sections 104(b)(2) and 106(c) simply retained the very "just and reasonable" ratemaking standard under which FERC and its predecessor, during the preceding 30 years, had created, modified, adjusted and, occasionally, abrogated the vintage pricing system. See FERC Br. 30-31, Producers Br. 20. There is therefore no reason why those provisions should have been controversial.

Moreover, respondents' implicit concession that Congress did not speak directly to the precise question of FERC's authority to collapse vintage pricing under the NGPA is dispositive. Congressional silence necessarily means that, even if the FERC's interpretation were not compelled by the plain statutory language (see *supra* pp. 7-8), that interpretation is entitled to judicial deference as long as it is reasonable. See *Chevron*, 467 U.S. at 843 (deference rule applies if Congress has not "directly addressed the precise question at issue"). The Commission's interpretation of the NGPA plainly satisfies that standard for the reasons discussed above (*supra* pp. 6-9) and in

petitioners' opening briefs (FERC Br. 24-30, Producers Br. 18-23, 27-32).

Third, respondents argue that the plain statutory language should be ignored—and FERC's interpretation accorded no deference—because the FERC, according to respondents, has previously interpreted Sections 104(b)(2) and 106(c) as limited to "special relief." Resp. Br. 38-41, 45 n. 19. This argument is frivolous. Despite its lengthy and repetitious discussions of several FERC decisions (Resp. Br. 8-18, 38-41), respondents' brief fails to identify a single decision that even suggests, let alone states, that the FERC's authority under Sections 104(b)(2) and 106(c) is *limited* to special relief. To be sure, the Commission has interpreted those statutory provisions as a source of *authority* for providing special relief. But respondents themselves acknowledge (at 16-17 n. 7) that the very Order in which the FERC expressly analyzed the special relief issue stated that "the authority under these sections may extend much further." Order No. 107-A, 48 Fed. Reg. 45,097, 45,101 n. 14 (Oct. 3, 1983).

B. The Order 451 Ceiling Price

Having failed to show that the Commission exceeded its authority in setting a single ceiling price for all old gas vintages, respondents are left to contend that the ceiling price the Commission chose does not satisfy the "just and reasonable" standard of the Natural Gas Act. Yet respondents do not dispute that the Commission's cost-based methodology was an appropriate means of setting rates under that standard, and they do not claim that Order 451's ceiling price is unjustified under that methodology. See Resp. Br. 31. Rather, aside from their ubiquitous claim that this ceiling is "essentially" deregulatory (see *supra* pp. 1-2), respondents mount two new challenges, neither of which has merit.

First, respondents contend that Order 451's ceiling price is necessarily contrary to the just and reasonable standard because the FERC did not permit producers to charge

that price in all circumstances. Resp. Br. 22, 49-50. Putting aside the fact that respondents were the direct beneficiaries of this feature of Order 451, respondents' argument rests on a mischaracterization of the Commission's order. The Commission did not, as respondents suggest (Resp. Br. 48-52), hold as a general matter that collection of the new ceiling price would be unjust and unreasonable. Rather, it concluded that it would be unreasonable for producers to be able to collect that price automatically, without new negotiations. J.A. 141, 310-11. In so doing, the Commission merely followed its well-established and judicially-approved practice of imposing a reasonable *condition* on the producer's right to collect the ceiling price.[7] Nothing in the NGA or the NGPA precludes the Commission from attaching such conditions to the collection of an otherwise just and reasonable ceiling price.[8]

Moreover, respondents' argument on this point incorrectly assumes that there can be only one "just and reasonable" price. This Court's decisions, by contrast, establish that there is an entire range of acceptable prices, *i.e.*, a "*zone* of reasonableness." *E.g., In re Permian Basin Area Rate Cases*, 390 U.S. 747, 797 (1968) (emphasis added); *FERC* v. *Pennzoil Producing Co.*, 439 U.S. 508, 517 (1979) (same). In Order 451, the Commission determined that this range included, at a mini-

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[7] See, *e.g., Shell Oil Corp.* v. *FPC*, 520 F.2d 1061, 1077 (5th Cir. 1975), *cert. denied*, 427 U.S. 941 (1976) (upholding FPC rule conditioning collection of higher ceiling price on agreement to a "rollover" contract); *Pennzoil* v. *FERC*, 671 F.2d 119, 127-28 (5th Cir. 1982) (upholding FERC rule conditioning collection of higher ceiling price on customer's agreement to pay higher price); *Louisiana Power & Light Co.*, 15 F.E.R.C. ¶ 63,058 (1981) (collection of rates conditioned on continued investigation into price squeeze).

[8] Indeed, Section 101(b)(9) of the NGPA itself imposes a condition on the collection of *any* ceiling price set by the Commission: By specifying that a producer may collect the lower of the contract price or the maximum lawful price, that provision conditions the collection of the maximum lawful price on the existence of contractual authority to collect that price. See 15 U.S.C. § 3311(b)(9).

mum, the existing contract price as well as the new ceiling price. J.A. 94. The fact that the Commission took steps to ensure that the price actually paid would generally be *less* than the Order 451 ceiling (but within the zone of reasonableness) does not render the Order 451 ceiling unjust or unreasonable.

To the contrary, this feature of Order 451 greatly enhanced the consumer benefits of Order 451 because it ensured that the ceiling price would not become, in fact, a price floor. See J.A. 141, 295, 310. It therefore reflects the Commission's careful, balanced approach to resolving the problem of old gas pricing.

Second, respondents argue that Order 451 is unlawful because it provides "incentive" prices for old gas. See, *e.g.*, Resp. Br. 14, 20, 21, 29, 35, 36. This argument is really no more than a play on words. It is an attempt to confuse the ordinary consideration of producer incentives in the ratemaking process with the specialized meaning of the term "incentive price" used in a NGPA provision not applicable to this case.[9] As a term of art, "incentive price" refers to a special ceiling price which the Commission, acting under Section 107(b) of the NGPA, may establish to elicit production of so-called "high-cost" natural gas—for example, gas located at a depth of more than 15,000 feet. See 15 U.S.C. § 3317 (c)(5) (listing categories). Such a ceiling price may "exceed[] the *otherwise applicable* maximum lawful price to the extent that such special price is necessary to provide reasonable incentives for the production of such high-cost natural gas." 15 U.S.C. § 3317(b) (emphasis added).

But the mere fact that the NGPA delineates the Commission's authority to establish special "incentive prices" for certain categories of gas in no way precludes the Commission from taking producers' incentives into account when, in the ordinary ratemaking process, it applies the just and reasonable standard to ensure an adequate supply of natural gas. Even in that context, the Commission has always taken incentives into account, explicitly, and with judicial approval. *E.g., Mobil Oil Corp.* v. *FPC*, 417 U.S. 283, 319-20 (1974) (Commission may alter pricing formula to encourage production).

[9] Moreover, this argument is relevant, if at all, to the lawfulness of the price at which the Order 451 ceiling was pegged, and not, as respondents suggest (Resp. Br. 34-36), to the validity of the Commission's decision to collapse the vintage pricing structure for old gas.

Thus, the fact that Order 451's ceiling price was expressly designed to increase producers' incentives to produce old gas is no basis for invalidating that ceiling. To the contrary, the Commission's finding that these incentives would elicit an additional 11 trillion cubic feet of old gas, thereby increasing overall supply and reducing prices, is one reason why Order 451 should be *upheld* under this Court's "end result" test. See Producers Br. 21 (citing cases).[10]

[10] Respondents' argument (at 43) that the Commission contravened congressional intent by altering producers' *relative* incentives to produce old and new gas is nothing more than a restatement of their erroneous argument that Congress intended to deny the Commission the authority to modify the pricing structure initiated by the NGPA. See *supra* 6-10. *Any* order that affects the price of old gas alone changes the relative attractiveness of old and new gas.

Respondents' suggestion (at 29) that the FERC chose the highest possible ceiling price is also nonsense. The Commission expressly found that a ceiling price higher than the ceiling it selected—based upon a replacement-cost study submitted by producers—would have been amply justified. See J.A. 93, 252, 256. Instead, the Commission chose a lower ceiling price, namely, the ceiling price applicable to the post-1974 old gas vintage. This ceiling price, which was also based upon replacement costs, had previously been approved by the courts. See Producers Br. 24 & n. 10. Moreover, because the Commission wanted to set a single ceiling price in order to eliminate the distortions created by vintage pricing, and because Sections 104(b)(2) and 106(c) prohibit the Commission from reducing ceiling prices, the Commission had to set the new ceiling price at a level at least as high as the highest price applicable to any old gas vintage. Thus, the Commission actually chose the *lowest* ceiling price that would permit it to collapse the vintage pricing structure. See J.A. 43.

In sum, no one disputes that the FERC has authority to increase ceiling prices as long as the resulting ceilings are just and reasonable. Thus, respondents' only real complaint is that the FERC picked the wrong price. But ratemaking is the FERC's responsibility, and respondents have presented no compelling reason why this Court should second-guess the FERC's exercise of that responsibility in this case.

III. RESPONDENTS' CHALLENGE TO ORDER 451's ABANDONMENT PROCEDURE IS MERITLESS.

Section 7(b) of the NGA imposes three requirements, all of them procedural, for a lawful abandonment: (1) approval by the Commission, after (2) "due hearing" and (3) a finding of public convenience and necessity. See Producers Br. 32-33, FERC Br. 39. Respondents do not dispute that Order 451 satisfies the first requirement. Instead, they argue that the hearings the Commission held (which included a detailed examination of the specific circumstances of several pipeline customers, see J.A. 286-93) and the "public convenience and necessity" finding the Commission made in promulgating Order 451 fail to satisfy the second and third requirements. Respondents contend that Section 7(b) requires the Commission to provide "*all* interested parties—not just the immediate parties to the contract" (Resp. Br. 60) with an opportunity for a particularized hearing and a public interest finding made, not on the basis of "market generalities," but on the basis of the "specific circumstances and equities" (Resp. Br. 62) surrounding the abandonment. See Resp. Br. 59-67.[11]

[11] Without even addressing petitioners' analysis of this point (see Producers Br. 42-46), respondents also argue in passing that the GFN procedure created by Order 451 gives producers excessive control of the abandonment decision, and thereby contravenes this Court's decision in *United Gas Pipe Line Co.* v. *McCombs*, 442 U.S. 529 (1979). Respondents' reading of *McCombs*, however, confuses the first requirement of Section 7(b)—actual Commission approval, which was at issue in that case—with the other two requirements, which were not. Respondents' complaints (at 23-25, 31, 62-63) about the "one-sidedness" of the GFN procedure, moreover, call for factual and political judgments that only the FERC—or Congress—is equipped to make.

Respondents do not dispute, however, the Commission's observation that a case-by-case hearing requirement for every abandonment undertaken pursuant to Order 451 would cripple the FERC's regulatory system by creating "lengthy delays before individual abandonments could be granted," thereby "seriously imped[ing] the achievement of this rule's goals of increasing production of old gas and reducing overall prices." J.A. 148; see also Producers Br. 40-42. Nor do respondents dispute that their interpretation of Section 7(b) would effectively nullify the substantive abandonment standard the Commission applied in Order 451, a standard respondents have never challenged and do not purport to contest now. Because the abandonment standard applied in Order 451 turns entirely on generic judgments about the entire industry—*i.e.*, whether abandonment in certain well-defined circumstances serves the "overall needs of the market" (see Producers Br. 32)—that standard is fundamentally incompatible with respondents' plea that the Commission be required to examine the "specific circumstances and equities" of each abandonment.[12]

[12] Contrary to respondents' suggestions (Resp. Br. 66-67), the standard applied in Order 451 is fully consistent with the Commission's decision in *Felmont Oil Corp.*, 33 F.E.R.C. ¶ 61,333 (1985), *rev'd on other grounds sub nom. Consolidated Edison Co.* v. *FERC*, 823 F.2d 630 (D.C. Cir. 1987). As in *Felmont*, the Commission expressly considered the interests of existing customers and determined (a) that those interests were outweighed by the needs of the market as a whole whenever the customer was unwilling to pay the new ceiling price, and (b) that the customers' interest in supply security would be best served by a strong national gas market. J.A. 147, 304-05.

The fact that in Order 451 the Commission made this finding on a generic basis rather than a case-by-case basis is irrelevant. Whereas in *Felmont* the Commission weighed the interests of one purchaser against the overall needs of the market (33 F.E.R.C.

Any reviewing court should be loath to interpret a statutory *procedural* requirement in a manner that intrudes so deeply into the agency's substantive rulemaking authority.[13] This Court need not and should not do so in this case because respondents' interpretation of Section 7(b) is simply incorrect.

First, that interpretation has no support in the language, structure or history of the Natural Gas Act, none of which respondents bother to analyze. Nothing in the language of Section 7(b) suggests that a hearing must be conducted and findings made specifically with reference to a particular abandonment. As petitioners have previously shown (Producers Br. 36-37, FERC Br. 43), the word "hearing" includes generic hearings as well as case-by-case hearings, and it is well settled that public interest findings may be made on a generic basis. See, *e.g.*, *FPC* v. *Moss*, 424 U.S. 494, 500-01 (1976) (rejecting contrary argument); *FCC* v. *WNCN Listeners Guild*, 450 U.S. 582, 594 (1981) (same). That the word "hearing" is modified by "due," moreover, indicates that the FERC is entitled to substantial flexibility in determining what procedure is required in any given circumstance. See Producers Br. 37. In short, respondents provide no reason why this Court should not defer to—and

¶ 61,333 at 61,657), Order 451 (through the GFN procedure) permits the purchaser to make that determination for itself. As petitioners have previously explained (Producers Br. 45), a purchaser can always defeat an abandonment simply by paying the applicable ceiling price—or any lower price it can negotiate with the producer. If the customer's need for the gas is not compelling enough to justify paying a price equal to (or less than) a just and reasonable ceiling price, the customer cannot plausibly claim that its own need for the gas outweighs the needs of the overall market or, indeed, the needs of other customers willing and able to pay a higher price. See J.A. 304-06.

[13] See, *e.g* . 2 Koch, Administrative Law and Practice 139 (1985); *NRDC* v. *NRC*, 685 F.2d 459, 535 (D.C. Cir. 1982) (Wilkey, J., dissenting) (citing *Vermont Yankee Nuclear Power Corp.* v. *NRDC*, 435 U.S. 519, 549 (1978), and accusing majority of "disguis[ing] a strict substantive review . . . in a fundamentally procedural rubric"), *rev'd*, 462 U.S. 87 (1983).

adopt—the Commission's interpretation of its own organic statute. See FERC Br. 38-39, Producers Br. 37.

Second, none of the decisions on which respondents rely (at 63-64) even suggests that an agency must engage in case-by-case analysis of facts that are irrelevant under the agency's substantive standard—or, equivalently, that an agency must conduct a case-by-case inquiry to determine whether it should make an exception to its generally applicable rules. In *FPC* v. *Texaco Inc.*, 377 U.S. 33 (1964), for example, this Court held that the Federal Power Commission could, consistent with the hearing requirement of Section 7(c) of the NGA, "particulariz[e] statutory standards through the rulemaking process and bar[] *at the threshold*"—*i.e.*, without any adjudicatory hearing—those who did not "measure up" to the agency's standards. *Id.* at 39 (emphasis added); see Producers Br. 38.[14]

[14] Similarly, in *United States* v. *Storer Broadcasting Co.*, 351 U.S. 192, 205 (1956), this Court held that the FCC, acting without a fact-finding hearing, could summarily deny certain license applications based upon standards adopted in a rulemaking. And in *Heckler* v. *Campbell*, 461 U.S. 458, 465-68 (1983), the Court held that the Secretary of Health and Human Services could properly (a) resolve certain issues bearing on determinations of disability in a rulemaking proceeding, and (b) rely upon the resulting rule rather than litigating those issues anew in each adjudication. The Court reached this conclusion even though, unlike Section 7(b), the express terms of the relevant statute required "individualized determinations based on evidence adduced at a hearing." *Id.* at 467.

Respondent's reliance upon this Court's statement in *McCombs* that Section 7(b) "prohibits abandonment absent specific findings by the Commission" (Resp. Br. 59, quoting 442 U.S. at 536) is frivolous. Inasmuch as this sentence immediately follows the Court's quotation of Section 7(b), it is clear that the "specific findings" to which the Court was alluding were the two findings specified in the statute itself, *i.e.*, "that the available supply of natural gas is depleted to the extent that the continuance of service is unwarranted, or that the present or future public convenience or necessity permit such abandonment." 442 U.S. at 536 (quoting Section 7(b)). Nothing in Section 7(b) or in *McCombs* remotely suggests that these findings must be "specific" to a particular abandonment.

What those decisions did suggest, in dicta, was that an agency should afford a hearing to resolve any disputes over facts bearing on the *applicability* of the agency's standard, *i.e.*, on whether the requirements of the agency's rule or standard have been met. See, *e.g.*, *Texaco*, 377 U.S. at 40; *United States* v. *Storer Broadcasting Co.*, 351 U.S. 192, 205 (1956); *Heckler* v. *Campbell*, 461 U.S. 458, 467 n. 11 (1983). But respondents do not dispute that the Commission's complaint procedures (combined with the 30-day advance notice requirement under Order 451) afford them *that* opportunity. See Resp. Br. 63-64.[15]

Third, respondents' argument would require this Court to overrule *FPC* v. *Moss*, 424 U.S. 494, 496 (1976). That decision affirmed the Commission's authority to "pre-grant" abandonment years before the abandonment is to take place. If, as respondents argue (at 60-61), "*all* interested parties" must be given "an opportunity to be heard and to make a full presentation of the facts before any abandonment [can] occur," abandonment could never be pre-granted. The reason is that parties that were not "interested" at the time the authority was granted might well become "interested" at any time prior to the actual abandonment.[16] In short, both the

[15] As petitioners explained in their opening briefs (FERC Br. 44, Producers Br. 41 n. 21), the 30-day notice requirement in the GFN procedure (J.A. 296) is ample time to permit a purchaser to file a complaint requesting that the Commission reject an abandonment before it takes place. Although respondents contend, somewhat coyly, that an "opportunity for specialized treatment" is "wholly absent from the Commission's *automatic abandonment rule contained in Order No. 451*" (Resp. Br. 63 (emphasis added)), they do not dispute that the Commission's administrative complaint procedures provide such an opportunity. See 18 C.F.R. § 385.206. Nor do they dispute that the Commission would in fact consider evidence regarding a producer's compliance *vel non* with the GFN procedure. See Resp. Br. 64.

[16] Moreover, even if respondents' interpretation of Section 7(b) were correct, their argument, as now framed in their brief, is not ripe for review. As discussed above (*supra* note 15), the

statutory language and this Court's decisions squarely support the Commission's interpretation of Section 7(b).

IV. RESPONDENTS AGREE THAT THE FERC'S ANALYSIS OF THE TAKE-OR-PAY ISSUE PROVIDES NO BASIS FOR VACATING ORDER 451.

Respondents do not dispute that an order directly or indirectly requiring the Commission to address further or to resolve the take-or-pay issue would be an unwarranted intrusion into the FERC's regulatory prerogatives. See FERC Br. 47-48, Producers Br. 46-50. Consistent with their brief in opposition to the petitions for certiorari, however, respondents continue to argue that the court of appeals' statements on this question were merely precatory because "the court of appeals did not order the Commission to do *anything* with respect to the take-or-pay issue." Brief for the Respondents in Opposition at 29 (May 14, 1990) (emphasis added); see Resp. Br. 67-70. They thereby concede that this Court need not reach that issue to reverse the decision below *in toto*.[17] Moreover, by

Commission's complaint procedures provide ample opportunity for a purchaser to seek a hearing on a proposed abandonment before it occurs. Respondents' contention that this procedure is inadequate is based solely on their *prediction* that the Commission likely would not consider specific "circumstances and equities" in such a proceeding. See Resp. Br. 64. But this demonstrates precisely why respondents' argument is not yet ripe under well-settled principles: No one can know whether or to what extent the Commission would consider such matters until someone files a complaint challenging an abandonment proposed under Order 451. Petitioners are unaware of any such complaint (see Producers Br. 41 n. 21), and respondents provide no evidence that anyone has ever filed one. Thus, respondents' Section 7(b) claim cannot provide any basis for invalidating Order 451.

[17] Indeed, respondents do not dispute that the fourth issue decided by the court below—the mandatory transportation issue—is now moot, and therefore no longer provides any basis for vacating Order 451. See Producer Br. 49-50 n. 28. Thus, if the Court reverses the court of appeals' holdings with respect to the pricing and abandonment issues, the *only* proper course on remand is to deny respondents' petitions for review altogether.

failing to argue that the court below *should* have made the take-or-pay issue an independent ground for vacating Order 451, respondents implicitly concede that the Commission's analysis of that issue is no basis for vacating that Order now.

* * * *

In sum, respondents' scattershot arguments cast no doubt on the Commission's authority to adopt Order 451. As the Commission predicted, that Order has produced an "end result"—increased gas supplies and lower overall prices—that is unquestionably just and reasonable. And the Commission has ample authority under the NGPA and the NGA to adopt each of the elements of Order 451 challenged by respondents.

CONCLUSION

For these reasons, and for the reasons stated in petitioners' opening briefs, the decision below should be reversed.

Respectfully submitted,

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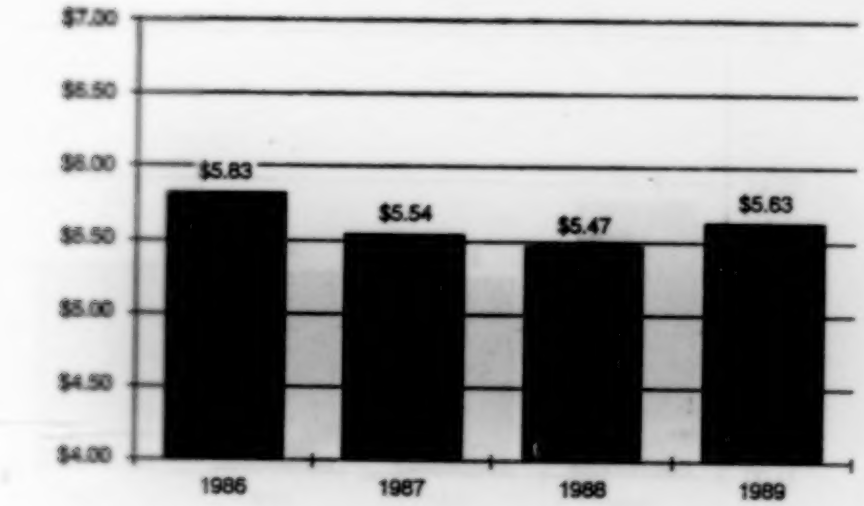
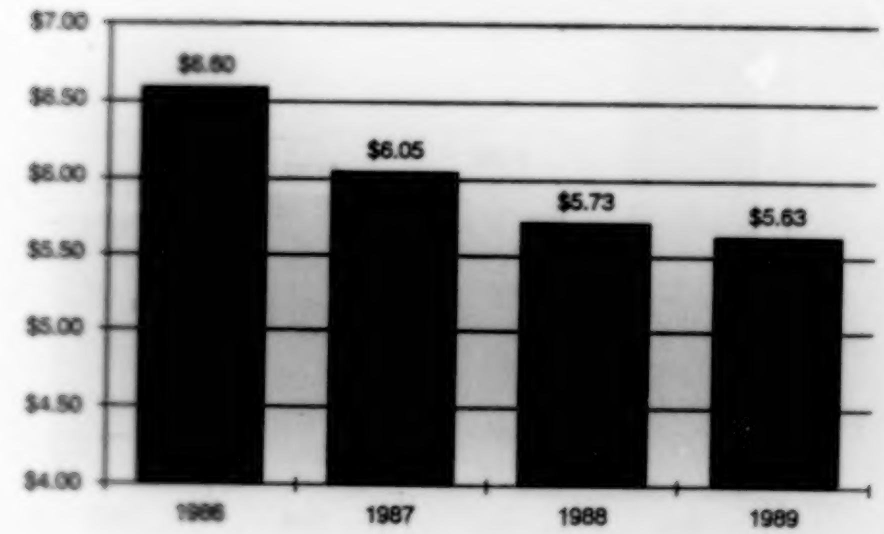
APPENDIX A

U.S. Residential Natural Gas Prices
(actual dollars)

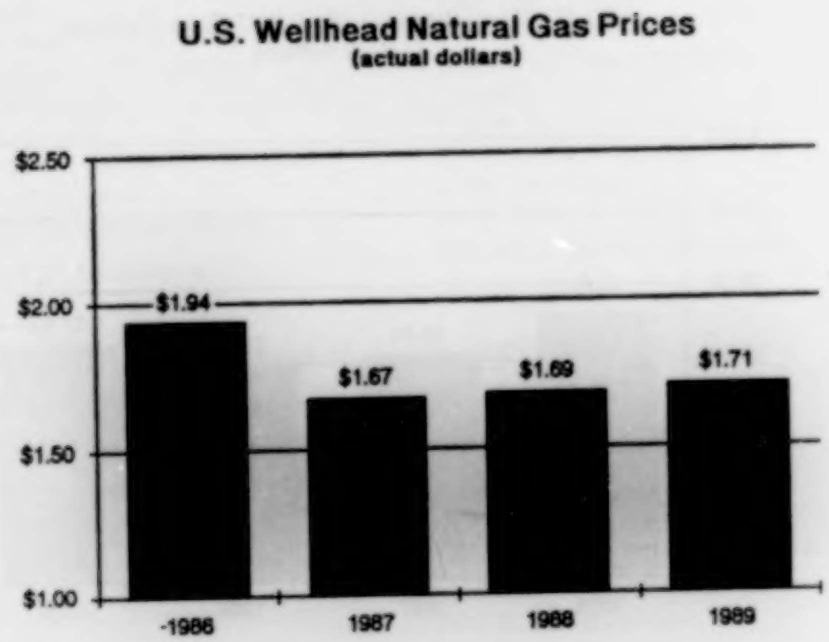


Source: DOE/EIA Monthly Energy Review, March 1990, Table 4

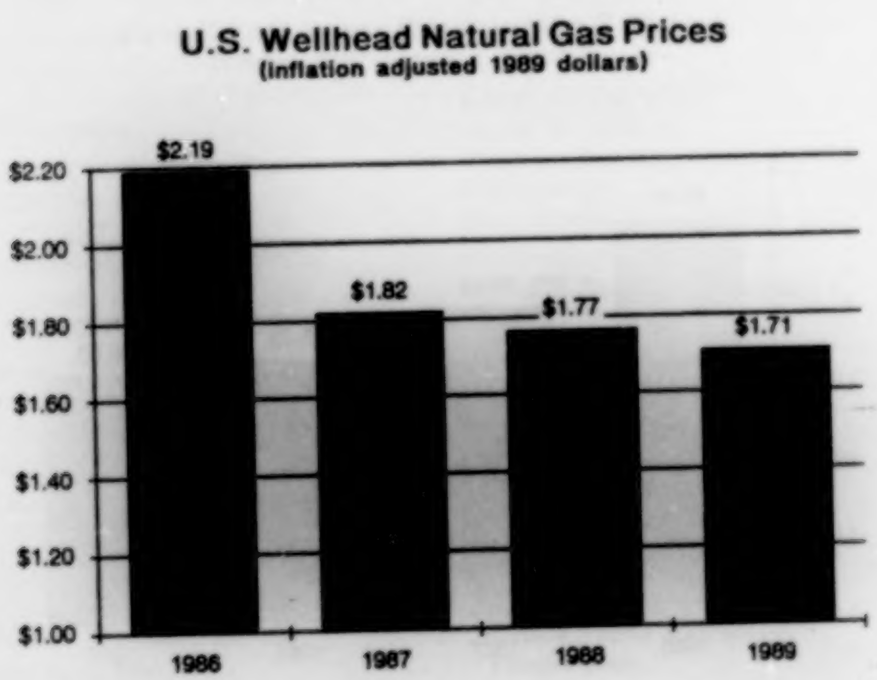
U.S. Residential Natural Gas Prices
(inflation adjusted 1989 dollars)



APPENDIX B



Source: DOE/EIA Monthly Energy Review, March 1990, Table 4



Nos. 89-1452 and 89-1453

In the Supreme Court of the United States

OCTOBER TERM, 1990

MOBIL OIL EXPLORATION & PRODUCING SOUTHEAST, INC., ET AL., PETITIONERS

v.

UNITED DISTRIBUTION COMPANIES, ET AL.

FEDERAL ENERGY REGULATORY COMMISSION, PETITIONER

v.

UNITED DISTRIBUTION COMPANIES, ET AL.

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

REPLY BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION

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TABLE OF AUTHORITIES

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ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

REPLY BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION

In Order No. 451, issued in 1986, the Federal Energy Regulatory Commission eliminated the anachronistic, multi-tiered system of vintage pricing that then existed for "old" gas (gas dedicated to interstate commerce prior to enactment of the Natural Gas Policy Act of 1978 (NGPA)). As we explain in our opening brief (FERC Br. 10-13, 27-29), the Commission determined, after exhaustive analysis, that the vintage-pricing system failed to assign a reasonable share of the "replacement" cost of developing new supplies to purchasers of old gas and cre-

ated artificial regional disparities, production disincentives, and other substantial distortions in the natural gas market. Exercising its authority under Sections 104(b)(2) and 106(c) of the NGPA to allow higher rates for old gas if they are "just and reasonable within the meaning of the Natural Gas Act," the Commission collapsed the fifteen "vintages" of old gas into a single category subject to a single price ceiling—the ceiling already in effect for one of those fifteen vintages (post-1974 old gas). That ceiling had previously been found by the Commission to be "just and reasonable" within the meaning of the Natural Gas Act (NGA) because it was based on then-current costs of exploration and production, had been sustained by the D.C. Circuit, and had been carried forward by Congress itself through Section 104(b)(1)(A) of the NGPA. After reexamining the issue in light of current data, the Commission concluded that this ceiling, as adjusted for inflation pursuant to the NGPA, continued to reflect the long-term replacement cost of developing new supplies and therefore continued to be just and reasonable. FERC Br. 6-7, 12-13, 20, 27-28.

The court of appeals did not disturb the Commission's judgment that the single price ceiling for old gas under Order No. 451 satisfies the requirement that a higher ceiling be "just and reasonable within the meaning of the Natural Gas Act." The court nevertheless held that the Commission was without authority to adopt that ceiling, holding that Sections 104(b)(2) and 106(c) must be construed much more narrowly to permit price increases only on a case-by-case basis in special circumstances. We show in our opening brief (FERC Br. 5-8, 24-38) that this holding is contrary to the text and legislative history of the NGPA and to the settled administrative and judicial interpretation of the NGA's "just and reasonable" standard at the time it was incorporated into Sections 104(b)(2) and 106(c).

I. Adopting the view of the court of appeals, respondents' principal submission (Br. 32-47) is that the single

price ceiling adopted by the Commission in Order No. 451 is inconsistent with the NGPA, whether or not that ceiling is "just and reasonable within the meaning of the Natural Gas Act." They argue that Sections 104(b)(1)(A) and 106(a) of the NGPA essentially froze, for all time, the prior system of vintage pricing for old gas and the general rate levels established under that system (adjusted for inflation), and that Sections 104(b)(2) and 106(c) should be narrowly construed to authorize the Commission to grant only "special relief" from those frozen rates on a case-by-case basis, such as where they are confiscatory as applied. Thus, in respondents' view, Sections 104(b)(2) and 106(c) do not permit the Commission to increase the price ceilings themselves and, in particular, do not permit the Commission to do so to create incentives for the production of additional supplies of gas. Instead, respondents maintain that the price ceiling for any vintage of old gas must be based exclusively on the historical costs of developing that gas. This argument is wrong in every respect.

A. The most basic flaw in respondents' submission is that it flies in the face of the statutory text. To be sure, Sections 104(b)(1)(A) and 106(a)(1) of the NGPA carried forward for the time being the applicable "just and reasonable rate * * * established by the Commission" (adjusted for inflation) as the maximum lawful price for old gas that was committed or dedicated to interstate commerce when the NGPA was enacted. But Sections 104(b)(2) and 106(c) both expressly provide that the Commission may, "by rule or order," prescribe a "higher" ceiling price for any such gas, "or any category thereof," as long as the new ceiling also is "just and reasonable within the meaning of the Natural Gas Act." We agree with respondents that this language permits the Commission to issue an "order" granting a particular producer special relief from the ceiling that is otherwise applicable to a category (vintage) of old gas. But the language permitting the Commission to establish a higher maximum lawful rate by a "rule" applicable to "any category" of old gas clearly contemplates rate in-

creases of general applicability as well, where, as here, the new ceiling is "just and reasonable within the meaning of the Natural Gas Act." Thus, far from being "inconsistent" with the NGPA, as respondents assert (Br. 32), the ceiling price for old gas under Order No. 451 is expressly authorized by the NGPA.

B. Respondents do not dispute that the text of Sections 104(b)(2) and 106(c) squarely supports the Commission's actions (see Br. 32-33), but they ask the Court to ignore the plain meaning of those provisions and to look instead to the structure, legislative history, and administrative interpretation of the NGPA. In fact, those sources of guidance likewise support the validity of Order No. 451.

1. Respondents contend (Br. 33-37) that the NGPA, "read as a whole," embodies a legislative compromise under which preexisting price ceilings for old gas were frozen (subject to adjustment for inflation) in return for the eventual deregulation of new gas. Nothing in the Act's structure, however, supports respondents' rigid view of the legislative compromise as it affects old gas, or otherwise detracts from the Commission's interpretation of Sections 104(b)(2) and 106(c).

Congress sought in the NGPA to eliminate the severe gas shortage in the interstate market caused by the complex system of rates applicable to different vintages of gas, under which price ceilings for interstate gas sales fell significantly below the price for gas in the intrastate market. See *Transcontinental Gas Pipe Line Corp.* v. *State Oil & Gas Bd. (Transco)*, 474 U.S. 409, 420-421 (1986); *Public Service Comm'n* v. *Mid-Louisiana Gas Co.*, 463 U.S. 319, 330-331 (1983). The NGPA therefore instituted a national market for natural gas and directed the Commission to "overse[e] a national market price regulatory scheme." *Transco*, 474 U.S. at 421. To that end, Sections 102 through 109 of the NGPA established an "exhaustive categorization of natural gas production" and "set[] forth a methodology for calculating an appropriate ceiling price within each category." *Mid-Louisiana Gas*, 463 U.S. at 332. The ceiling for each category was initially established either in terms of a dollar figure per

million Btu's or (as in the case of old gas) in terms of a previously existing price, but it is then adjusted upward over time according to a statutory formula. *Id.* at 333. This automatic upward adjustment, which was made equally applicable to old gas and new, refutes respondents' contention (Br. 34-36) that the NGPA mandates a purely historical-cost approach in setting price ceilings for old gas and precludes the Commission from taking into account the very considerations that led to enactment of the NGPA: the need to create incentives for developing additional supplies and the need to bring order to the natural gas market. The Court recognized as much in *Mid-Louisiana Gas*, explaining that "[i]n *each* category of gas"—necessarily including the categories of old gas covered by Sections 104 and 106—"the statute explicitly establishes an *incentive* pricing scheme that is wholly divorced from the traditional historical-cost methods applied by the Commission in implementing the NGA." 463 U.S. at 333 (emphasis added).

For some categories of gas, "the NGPA ceiling prices [were] an intermediate step on the path from a fully regulated industry to a deregulated industry." *Mid-Louisiana Gas*, 463 U.S. at 336 n.14. Thus, "the price ceilings for certain 'high-cost' gas were eliminated in 1979, for certain 'old' intrastate gas and 'new' gas in 1985, and for certain other 'new' gas in 1987." *FERC* v. *Martin Exploration Management Co.*, 486 U.S. 204, 207 (1988); see 15 U.S.C. 3331. By contrast, the NGPA itself does not lift price controls for old gas or raise the grandfathered price ceilings beyond the levels they attain under the automatic adjustment mechanism. But this does not mean that the NGPA bars the *Commission* from raising those ceilings if circumstances warrant. To the contrary, as the Court pointed out in *Mid-Louisiana Gas*, Congress recognized that even a price ceiling generated by the NGPA's new "incentive pricing scheme" for old gas "may be too *low* and authorize[d] the Commission to raise it whenever traditional NGA principles would dictate a higher price." 463 U.S. at 333. The fact that Congress anticipated that the incentives furnished by the

NGPA's automatic adjustments might be insufficient as applied to old gas strongly supports the Commission's decision to consider the need for *additional* incentives in fashioning the price ceiling in Order No. 451.

This conclusion is also strongly supported by the NGPA's use of the NGA's familiar "just and reasonable" standard to guide the Commission when prescribing a higher price ceiling for old gas. As we have explained (FERC Br. 3-8, 31-34), prior to the NGPA, that standard had consistently been construed in a broad and flexible manner. Of particular relevance here, the Commission, sustained by this Court and other courts, had "shift[ed] from a pure historical-cost-based to an incentive-price-based approach," *Mid-Louisiana Gas*, 463 U.S. at 330, "spread[] * * * over both old and new gas" the cost of developing additional sources of supply, *Mobil Oil Corp.* v. *FPC*, 417 U.S. 283, 320 (1974), and incorporated replacement-cost methodology in its ratemaking. J.A. 77-81. Indeed, shortly before the NGPA was passed, the Commission had "temporarily abandon[ed] the practice of vintaging," *Mid-Louisiana Gas*, 463 U.S. at 330 n.10 (citing Order No. 699-H, 52 F.P.C. 1604, 1636 (1974), aff'd, *Shell Oil Co.* v. *FPC*, 520 F.2d 1061, 1073-1074 (5th Cir. 1975), cert. denied, 426 U.S. 941 (1976)), and collapsed a number of pre-1973 vintages for separate producing areas into a single nationwide category. Order No. 749, 54 F.P.C. 3090 (1975), aff'd, *Tenneco Oil Co.* v. *FERC*, 571 F.2d 834, 841-842 (5th Cir.), cert. denied, 439 U.S. 801 (1978).

Thus, under the compromise embodied in the NGPA, Congress chose to treat old gas differently not by preserving for all time the particular *price ceilings* the Commission had established for various vintages of old gas, but rather by preserving the *regulatory authority* under which those ceilings were adopted (albeit limited by the NGPA's prohibition against lowering the ceilings). In other words, the compromise was to preserve traditional NGA regulation of wellhead prices for old gas while eliminating such regulation for new gas. Accordingly, the structure of the NGPA as a whole reinforces the Commission's authority under Sections 104(b)(2) and 106(c) to adopt Order No. 451.

2. In turning to the legislative history, respondents (Br. 41-43), like the court of appeals, rely solely on generalized floor statements by individual Members of Congress concerning the differing treatment of old and new gas, none of which suggests that the Commission is powerless to revise the vintage-pricing system and raise the ceiling price of old gas under "traditional NGA principles." *Mid-Louisiana Gas*, 463 U.S. at 333.[1]

On the other hand, statements by Senator Abourezk and Senator Kennedy *do* strongly reinforce the validity of the Commission's approach in Order No. 451 by making clear that under the NGA's "just and reasonable" standard, price ceilings need not be wholly "cost-based" and may used as an "incentive" to "elicit" and "bring forth" new supplies. 124 Cong. Rec. 30,018, 30,023 (1978); see FERC Br. 37. Respondents attempt (Br. 43) to minimize these statements on the ground that they were made by opponents of the NGPA, whose "fears and doubts" are not authoritative guides to the Act's meaning. Respondents miss the point. Senators Abou-

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[1] Respondents principally rely (Br. 42) on Senator Jackson's observation that the NGPA "concentrates" the rewards of higher prices on the development of new, high-cost gas, thereby encouraging production while protecting consumers from paying "unnecessarily high" prices for gas they could expect to receive at "lower prices" under "current policies." 124 Cong. Rec. 28,633 (1978). This description does not imply that the NGPA embodies an absolute prohibition against higher ceilings for old gas. In fact, Senator Jackson's reference to then-"current policies" indicates that the Commission may revise the vintage-pricing structure and utilize replacement-cost methodology for old gas after passage of the NGPA, just as it did before. Senator Domenici's statement that "deregulating" old gas was never suggested and that elimination of vintaging in the NGPA itself was "not doable," *id.* at 28,865, is not to the contrary. Order No. 451 does not "deregulate" old gas (see pages 14-15, *infra*), and Congress's failure to mandate elimination of vintage pricing for old gas when it enacted the NGPA scarcely suggests that the Commission was to be barred from doing so years later, in light of changed circumstances.

rezk and Kennedy opposed the NGPA because of the higher price ceilings and phased deregulation it provided for *new* gas, and they argued that the Commission already had sufficient authority under the NGA's "just and reasonable" standard to create incentives and elicit new supplies, thereby accomplishing many of the NGPA's objectives. The views of these Senators therefore cannot be discounted on the premise that they were opposed to applying the "just and reasonable" standard to the gas at issue here. In fact, the acknowledgement by two Senators who sought to hold down gas prices that the "just and reasonable" standard permits incentive-based price ceilings greatly weakens respondents' assertion that Congress was so single-minded in its desire to protect those consumers who were fortunate enough to have access to large supplies of old gas that it barred *any* increases in the overall price of such gas.

Respondents also essentially ignore the fact that Congress *rejected* a version of the NGPA that would have enacted the very regulatory scheme for old gas that they now insist is embodied in Sections 104 and 106. The House bill would have frozen the maximum lawful price of old gas at the just and reasonable rate established by the Commission before enactment of the NGPA, albeit increased by inflation. It would not have allowed the Commission to increase those ceilings on a generic basis; a producer would have been permitted to collect a higher price only under a special relief provision for high-cost gas. 123 Cong. Rec. 26,169 (1977) (§§ 405, 409). Borrowing from the Senate bill (*id.* at 32,306 (§ 3)), however, the bill reported by the Conference Committee and enacted into law as the NGPA retained the Commission's authority to regulate (and thereby increase) the price of old gas under the "just and reasonable" standard. FERC Br. 37-38. Respondents' submission that Sections 104(b)(2) and 106(c) only authorize the Commission to grant special relief from vintaged area or national rate ceilings on a case-by-case basis therefore is inconsistent with the settled rule that Acts of Congress are not to be construed implicitly to incorporate provisions that Congress specifically rejected. *INS* v. *Cardoza-Fonseca*, 480 U.S. 421, 442-443 (1987).

3. Finally, there is no basis for respondents' contention (Br. 8-18, 38-41) that Order No. 451 represents a dramatic break from prior administrative interpretations of Sections 104(b)(2) and 106(c) under which the Commission regarded its authority as limited to the granting of special relief. Not once in the materials respondents cite did the Commission state that its authority was limited in this manner and that it therefore could not increase price ceilings for old gas on a generic basis. To the contrary, in the first of the interpretations cited by respondents (Br. 10-11), the Commission stated, citing Sections 104(b)(2) and 106(c), that although the NGPA's ceiling prices generally struck the balance between consumer and producer interests, the Act reserved to the Commission "the authority to prescribe *higher* price ceilings in certain circumstances." Order No. 23, 44 Fed. Reg. 16,895, 16,897 & n.10 (1979).[2]

Respondents next rely (Br. 11-13, 38-39) on proposals published by the Commission between 1979 and 1984 to adopt procedures under Sections 104(b)(2) and 106(c) for granting special relief from area or national rate ceilings that was comparable to the relief available under rate orders issued pursuant to the NGA. See *Permian Basin Area Rate Cases*, 390 U.S. 747, 770-774 (1968), aff'g 34 F.P.C. 159, 180, 226 (1965); 18 C.F.R. 2.56a(g), 2.56b(h), 2.75 (1980).[3] The Com-

[2] Respondents also quote (Br. 9-10) a letter from Commission Chairman Curtis to Senator Jackson, while the NGPA was under consideration, which stated that "[e]xcept in instances where the Commission receives applications for rates in excess of the maximum lawful prices under the NGPA (in which case it may establish a higher price if it meets just and reasonable standards), the Commission will no longer inquire into producer costs nor establish permissible rates of return." This passage does not suggest that the Commission would entertain only those applications that sought special relief from existing price ceilings, as distinguished from an increase in the ceilings themselves.

[3] This parallel was the basis for the Commission's statement, quoted by respondents (Br. 12), that Congress "provided a link

mission never suggested, however, that its authority under the "just and reasonable" standard in Sections 104(b)(2) and 106(c) might be confined to granting special relief from applicable rate ceilings and that it was therefore barred from increasing the ceilings themselves.

In fact, even prior to the Commission's withdrawal of the proposed rules governing special relief, the Commission stated in a final order cited by respondents (Br. 14-16) that "price inadequacies" for old gas and interstate gas subject to rollover contracts "could be remedied by either a special relief rulemaking or a new just and reasonable rate proceeding pursuant to sections 104(b)(2) and 106(c) of the NGPA." Order No. 107-A, 48 Fed. Reg. 45,097, 45,098 (1983). The Commission further explained that "[w]hile sections 104(b)(2), 106(c), and 109(b)(2) provide the Commission with statutory authority to establish at a minimum a special relief program, the Commission notes that the authority under these sections may extend much further." *Id.* at 45,101 n.14. The Commission cited for that proposition a 1982 Notice of Inquiry, in which it solicited comments on how to alleviate severe economic distortions that were beginning to plague the natural gas industry. *Impact of the NGPA on Current and Projected Natural Gas Markets*, 47 Fed. Reg. 19,157 (1982). In that Notice, which first identified many of the issues addressed by Order No. 451 (see J.A. 58-59), the Commission expressed its belief (supported by a legal memorandum appended to the Notice, 47 Fed. Reg. at 19,165-19,168) that it "may have the authority to eliminate vintaging in whole or in part under section 104 and to identify and establish

between the NGA's special relief procedures and the NGPA in sections 104(b)(2) [and] 106(c)." 49 Fed. Reg. 21,910 (1984). The fact that the Commission has authority under Sections 104(b)(2) and 106(c), by "order," to grant special relief from a vintaged price ceiling (which links those Sections to the prior special relief regulations) does not negate the Commission's authority, by "rule," to set a higher ceiling for "any category" of old gas (which links those Sections to the ceilings themselves).

a single maximum lawful price applicable to sections 104, 106 and 109 in order to mitigate potential market ordering problems." *Id.* at 19,162. This background refutes respondents' contention that the Commission previously fixed the limits of its authority under Sections 104(b)(2) and 106(c) in a way that is inconsistent with the approach it took in Order No. 451.[4]

II. Respondents further argue (Br. 47-57), apparently as an alternative ground for affirmance, that even if a higher price ceiling for old gas is lawful so long as it is "just and reasonable" within the meaning of the NGA, the ceiling in Order No. 451 does not satisfy that standard. But in making this argument, respondents all but ignore the Commission's exhaustive analysis of the issue. They do not challenge the Commission's finding that the prices permitted under the prior system of vintage pricing were unjust and unreasonable because they led to production disincentives, regional disparities, and other market distortions; the legality of the Commission's use of a replacement-cost methodology in setting a new ceiling under the just and reasonable standard; the data and factual findings on which the Commission relied in applying that methodology; or the validity of the Commission's ultimate conclusion that the particular ceiling it chose is just and reasonable. See Resp. Br. 20-21, 31, 47-48, 57. The sole points respondents make in arguing that this ceiling is not just and reasonable are based on quite different grounds. Both points are insubstantial.

A. First, respondents erroneously contend (Br. 48-52) that the revised price ceiling cannot be deemed just and reasonable because the Commission itself concluded when it promulgated Order No. 451 that it is a rate that "should not be collected." The Commission did not state

[4] Even if the Commission had expressed a view to the contrary, that would not prevent the Commission from reexamining its initial interpretation in light of changed circumstances, especially in the exercise of its flexible "just and reasonable" ratemaking authority. *Chevron U.S.A. Inc.* v. *NRDC, Inc.*, 467 U.S. 837, 863-864 (1984); see also *NLRB* v. *Curtin Matheson Scientific, Inc.*, 110 S. Ct. 1542, 1549 (1990).

that it would be unjust and unreasonable for gas producers to collect prices up to the revised ceiling for old gas. To the contrary, the Commission repeatedly stated that the ceiling price is within a "zone of reasonableness" (see *Permian Basin*, 390 U.S. at 767) and therefore "just and reasonable" within the meaning of the NGA. See J.A. 43, 95, 112, 310, 311. The Commission simply found that it would not be appropriate for gas producers *automatically* to collect that rate simply by invoking the indefinite price escalator clauses contained in most producer-pipeline contracts—especially since the ceiling price was (and remains) above the market price. See J.A. 141, 310-311. The Commission therefore included the Good Faith Negotiation (GFN) procedure in Order No. 451 to ensure that a producer would collect the new ceiling price (or any other price above the prior ceiling) only from purchasers willing to pay it. FERC Br. 13-15, 40-42. The Commission's conclusion that the ceiling price adopted in Order No. 451 is just and reasonable for purposes of rate regulation did not somehow estop it from tailoring the implementation of that ceiling to mitigate its impact on purchasers and to prevent the market distortions that otherwise would have been created by widespread collection of above-market rates. After all, the NGA authorizes the Commission to regulate a natural gas company's "practices" as well as its "rates." § 5(a), 15 U.S.C. 717d(a).

Since the GFN procedure was intended to *protect* respondents and other pipelines and pipeline customers against automatic rate increases under price escalator clauses to which they had voluntarily agreed, it is rather odd for respondents to argue that the otherwise lawful ceiling in Order No. 451 is rendered unjust and unreasonable *because of* the GFN procedure. Undeterred, respondents object (Br. 50-52) to certain details of the GFN procedure as well, characterizing it as "hopelessly skewed in favor of producers" (Br. 50). This characterization is simply wrong. Respondents' principal complaint is that only the producer can initiate the GFN process (by requesting the pipeline to nominate the

price at which it would continue to purchase old gas under one or more contracts between the parties). See FERC Br. 14. This complaint ignores the fact that if the producer does *not* initiate the GFN process, the pipeline may continue to purchase old gas at the prior (lower) ceiling price; the pipeline therefore is no worse off by virtue of its inability to initiate the GFN process than it would be if there were no GFN process at all.[5]

Respondents' argument also misapprehends the purpose of the GFN process. That process was not designed to furnish an independent means for producers and pipelines to renegotiate their contracts as a general matter; it had the more limited purpose of providing some opportunity for a pipeline to mitigate the adverse effects of a price increase to which the producer would otherwise be automatically entitled under the contract. The pipeline therefore has no right to insist on an opportunity, equal to that of the producer, to achieve a net *advantage* in its overall bargaining position through the

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[5] Similarly, respondents disparage (Br. 51-52) the opportunity the GFN process affords a purchaser to renegotiate *any* contract with that producer covering at least some old gas and to terminate any such contract if the producer does not agree to the price the pipeline nominates; in respondents' view, a pipeline is unlikely to realize any net benefit from these features of the GFN process because the producer is unlikely to initiate that process unless it believes that the negotiations will work to its advantage. This complaint once again ignores the fact that a pipeline is no worse off by virtue of its inability to trigger the GFN process where the producer fails to do so, since the pipeline may then continue to purchase gas at prices that are unaffected by the new ceiling price in Order No. 451.

Respondents likewise err in asserting (Br. 51) that under the GFN process, "the producer has *no* incentive to reach any 'mutually agreed-upon price' other than the new ceiling price, and may use the threat of termination and abandonment to obtain it." If the new ceiling price is above the prevailing market price (as it has been since Order No. 451 was promulgated), the producer *will* have an incentive to agree to a below-ceiling price in order to sell the gas; otherwise the pipeline may exercise its right under the GFN process to terminate the contract and purchase gas elsewhere at the market price. See FERC Br. 14-15.

GFN process. Further, respondents' unfairness argument overlooks the Commission's assessment when it adopted Order No. 451 that the adverse effect on a particular purchaser as a result of its loss of a contract entitlement to a particular amount of old gas at a particular price by operation of the GFN process would be limited by virtue of the ready availability of alternative sources of supply at market-responsive prices. J.A. 304; see Pet. App. 54a (Brown, J., dissenting); FERC Br. 41-42.

B. Also without merit is respondents' contention (Br. 48, 52-57) that the pricing provisions of Order No. 451 are not just and reasonable because they "deregulate" the price of old gas. The old gas at issue here remains subject to the price ceiling specifically set forth in Order No. 451 itself. That ceiling was first adopted by the Commission for post-1974 old gas in the exercise of its NGA authority to regulate gas prices under the "just and reasonable" standard, and it is the very ceiling that the NGPA itself carries forward (as adjusted for inflation) for post-1974 old gas, expressly recognizing in the text of Section 104(b)(1)(A) that it had been "established by the Commission" as "just and reasonable."

It could not seriously be contended that the price of post-1974 old gas has been "deregulated" simply because the statutorily mandated ceiling for that gas now happens to be above the current market price for natural gas generally: that ceiling remains fully effective as a legal matter and it may again have teeth as a practical matter if the market price should rise substantially in the future. It follows that the price of other vintages of old gas to which the Commission extended the same ceiling in Order No. 451 likewise has not been "deregulated" simply because that ceiling is above the current market price. See *Martin Exploration*, 486 U.S. at 208-209 (noting that "market prices had plunged below the regulated price ceilings" and that a provision of law "deregulates" when it "sets no price ceiling at all").[6] Thus, Order No. 451 in no way conflicts with the Court's observation in *FPC* v. *Texaco*, 417 U.S. 380 (1974), quoted by respondents (Br. 55), that "the prevailing price in the market place cannot be the *final* measure of 'just and reasonable' rates." *Id.* at 397 (emphasis added).[7]

III. In addition to objecting to the new price ceiling in Order No. 451, respondents challenge (Br. 57-67) the provisions that grant prior authorization to a producer to abandon its contract service obligations to a purchaser

[6] This conclusion is consistent with the regulatory premises of the NGPA. Under that Act, "[a]ll maximum lawful prices are ceiling prices only. In no case may a seller receive a higher price than his contract permits." H.R. Conf. Rep. No. 1752, 95th Cong., 2d Sess. 74 (1978); see 15 U.S.C. 3311(b)(9) (codifying the rule of *United Gas Pipeline Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 333, 343 (1956), and *FPC* v. *Sierra Pacific Service Co.*, 350 U.S. 348, 353 (1956)). Consequently, "the sales price, given sufficient economic conditions, can be established at a point below that ceiling." *Pennzoil Co.* v. *FERC*, 645 F.2d 360, 372 (5th Cir. 1981), cert. denied, 454 U.S. 1142 (1982). Because the NGA and NGPA permit rates to be negotiated by private parties, respondents err in relying (Br. 46, 54) on the discussion in *Maislin Industries, U.S., Inc.* v. *Primary Steel, Inc.*, 110 S. Ct. 2759 (1990), of negotiated rates under the tariff-based rate system prescribed by the Interstate Commerce Act, 49 U.S.C. 10101 *et seq.*

[7] In spinning out their "deregulation" theme, respondents refer (Br. 23, 25, 53, 58) to provisions of Order No. 451 that (i) pre-grant producers a blanket certificate of public convenience and necessity under Section 7(c) of the NGA to resell gas that is released under the GFN and abandonment provisions, and (ii) waive certain filing requirements under Section 4 of the NGA. J.A. 46, 164, 179-181. Respondents do not appear to present these points as distinct legal objections to the Order, and any such objections are not properly before the Court because they were not presented below or in the brief in opposition. In any event, the Commission has previously pre-granted certificates of public convenience and necessity on a generic basis, most prominently in the extensive proceedings on Order Nos. 436 and 500, cited in FERC Br. 46 n.18, concerning open-access pipelines. See 18 C.F.R. 284.221; *Associated Gas Distributors* v. *FERC*, 824 F.2d 981, 997 (D.C. Cir. 1987), cert. denied, 485 U.S. 1006 (1988); *American Gas Ass'n* v. *FERC*, No. 87-1588 (D.C. Cir. Aug. 24, 1990), slip op. 33; see also *FPC* v. *Texaco*, 417 U.S. 380, 384 (1974). Similarly, the Commission waived filing requirements under the NGA when it granted regulatory relief to small producers. *FPC* v. *Texaco*, 417 U.S. at 384; *Permian Basin*, 390 U.S. at 786-787; 34 F.P.C. 159, 234-235 (1965); Order No. 428, 45 F.P.C. 454, 458 (1971); see 18 C.F.R. 157.40(c) and (d).

upon the occurrence of specified conditions. Those conditions are: the producer and purchaser were unable to reach agreement on a revised price for old gas within the framework of the GFN procedure; the purchaser elected not to continue to buy the gas in question at a price nominated by the producer; the producer has entered into a contract to sell the same gas to another purchaser; and the producer has given the purchaser 30 days notice. See FERC Br. 14-15, 40.

By permitting abandonment under these circumstances, the Commission did not, as respondents argue (Br. 57), "discard" the requirements of Section 7(b) of the NGA. To the contrary, as we explain in our opening brief (FERC Br. 38-44), the Commission complied with all three requirements prescribed by that Section. First, the Commission gave its "permission and approval" to abandonments of service upon the future occurrence of the specified protective conditions. FERC Br. 39-40; compare *FPC* v. *Moss*, 424 U.S. 494 (1976) (sustaining Commission's authority under Section 7(b) to give advance approval of abandonment). Second, the Commission made the requisite "finding" that the "present or future public convenience or necessity" justifies abandonment where those conditions have been satisfied among the parties concerned, both because it assures that the gas in question will promptly be made available to a willing purchaser, and because the availability of that option to the producer (along with the reciprocal right of the purchaser to terminate the contract) if the parties do not reach agreement under the GFN negotiating process creates an inducement for that process to work if it is invoked. FERC Br. 40-41 & n.16; cf. *FPC* v. *Moss*, 424 U.S. at 501.

Third, the Commission's approach is fully consistent with Section 7(b)'s provision for approval of abandonment "after due hearing." Both the just and reasonable ceiling price for old gas and the factors warranting abandonment where a purchaser is unwilling to pay that price (or some lower price acceptable to the producer) were resolved in the rulemaking proceedings on Order No. 451, in which respondents and all other interested

parties had an opportunity to participate. No individualized hearing is "due" with respect to the ceiling price or the standards of public convenience and necessity warranting abandonment under the Order, which are of market-wide applicability.[8] Moreover, respondents have not filed a complaint under 18 C.F.R. 385.206 suggesting the need for an individualized hearing because of a dispute about whether a particular producer is complying with the price ceiling or whether the requisite standards under Order No. 451 have been satisfied in connection with any particular abandonment. FERC Br. 42-44.

Respondents nevertheless assert (Br. 60-64) that the terms "due hearing" and "finding" in Section 7(b) require the Commission to make an individualized assessment of each proposed abandonment, even where the factors specified in Order No. 451 are concededly present, so that the Commission can consider each abandonment's "probable effects on consumers and all other interested persons" (Br. 61) and "all of the circumstances and equities involved" (Br. 64). Respondents do not and cannot deny that such a regime of individualized hearings and specific findings would, as the Commission found in promulgating Order No. 451, "substantially delay[]" and frustrate the achievement of the Order's generically established, consumer-oriented goals. J.A. 301-302; FERC Br. 43. Nor do respondents deny that this Court and other courts have uniformly rejected a claim of right to an individualized determination in comparable circumstances, even where the relevant statute expressly calls for a "hearing." See Resp. Br. 63-67, citing *Heckler* v. *Campbell*, 461 U.S. 458 (1983); *FPC* v. *Texaco Inc.*, 377 U.S. 33 (1964); *United States* v. *Storer Broadcasting Co.*, 351 U.S. 192 (1956); *Kansas Power & Light Co.* v. *FERC*, 851 F.2d 1479 (D.C. Cir. 1988); and *Associated Gas Distributors* v. *FERC*, 824 F.2d 981

[8] Section 16 of the NGA, 15 U.S.C. 717*o*, specifically provides that "[f]or the purposes of its rules and regulations, the Commission may classify persons and matters within its jurisdiction and prescribe different requirements for different classes of persons or matters." See *Permian Basin*, 390 U.S. at 787.

(D.C. Cir. 1987), cert. denied, 485 U.S. 1006 (1988); see also *American Gas Ass'n* v. *FERC*, No. 87-1588 (D.C. Cir. Aug. 24, 1990), slip op. 36-38.

Respondents seek to overcome this adverse precedent in two ways. First, they argue (Br. 62) that Order No. 451 is different because it "placed the entire abandonment squarely in the hands of the producer." See also Br. 65. This distinction is legally irrelevant, because nothing in Section 7(b) absolutely prohibits the Commission from giving advance approval to an abandonment that is initiated entirely by the producer, if that approach is otherwise consistent with the public convenience and necessity and the requisite standards for abandonment are satisfied. There is no need to resolve that question here, however, because the purchaser in fact plays a central role in bringing about an abandonment under Order No. 451. The GFN process can never be triggered in the first place unless the purchaser has entered into a contract with a producer that allows a price increase up to the new just and reasonable price ceiling prescribed by Order No. 451 (typically in an indefinite escalator clause). And the producer may not abandon service at the end of the GFN process unless the purchaser refuses to pay the ceiling price or some lower price acceptable to the producer. As a result, as the Commission explained, "abandonment occurs * * * only if the purchaser has chosen not to pay the price provided for under the contract, in effect terminating the contract." J.A. 305; see also J.A. 312 ("any contract termination occurs through the parties' mutual exercise of their rights," and therefore is not "unilateral").

Second, respondents point (Br. 63) to the discussion in *Heckler* v. *Campbell*, *FPC* v. *Texaco*, and *Storer Broadcasting* of an opportunity for the affected person to show that the regulation should not be applied to him. It is not clear, however, why such a provision should invariably be necessary, irrespective of the particular statutory scheme and regulation involved. See *FCC* v. *WNCN Listeners Guild*, 450 U.S. 582, 601 n.44 (1981). For example, a price ceiling, such as the one in Order No. 451 that may lead to abandonment if the purchaser

refuses to pay it, is by nature a standard of general applicability that does not ordinarily admit of exceptions, at least in the absence of a showing that it is confiscatory or otherwise dramatically out of line in the circumstances.

Moreover, even if a court were to conclude that such a provision for special relief is necessary in the context of a particular rule, the appropriate remedy presumably would be to order the agency to entertain a petition for waiver or other relief in the exceptional case where such a petition has been filed and appears meritorious, not to strike down the rule itself. In *FPC* v. *Texaco*, for example, the Court cited a general regulation, issued pursuant to Section 16 of the NGA, that provided for the filing of petitions for waiver of Commission regulations under the NGA, but noted that the private party involved had not petitioned for such relief. 377 U.S. at 40 n.11 (citing 18 C.F.R. 1.7(b) (1963)). In this case, respondent Williams Natural Gas made a passing request for an exemption from Order No. 451 in its petition for rehearing (at 58) before the Commission, and it argued in its brief in the court of appeals (at 12-13) that the Commission was authorized by Section 16 of the NGA to grant it such an exemption and should have done so.[9] But we have been informed by the Commission that neither Williams nor any other purchaser ever filed a formal petition with the Commission for a waiver of the abandonment features of Order No. 451's GFN process. There accordingly is no occasion for the Court to address the need for or contours of any such special exemption here.[10]

[9] The particular provision of the Commission's regulations cited in *FPC* v. *Texaco* that addressed the subject of waivers under Section 16 of the NGA is no longer in effect, but the Commission still may entertain such a petition under the catch-all filing provision in 18 C.F.R. 385.207(a)(5). Section 502(c) of the NGPA, 15 U.S.C. 3412(c), expressly provides for waivers ("adjustments") of provisions of the NGPA and implementing regulations and orders based on "special hardship, inequity, or an unfair distribution of burdens." See 18 C.F.R. 385.1101 *et seq.*

[10] Respondents do not attempt to defend the decision below to the extent its discussion of take-or-pay clauses in pipeline-producer

For the foregoing reasons and those stated in our opening brief, the judgment of the court of appeals should be reversed.

Respectfully submitted.

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OCTOBER 1990

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contracts (see Pet. App. 29a-32a) might be read to hold that the Commission was required to implement a solution to the take-or-pay problem as between producers and pipelines prior to or in connection with any order raising the price of old gas. See Resp. Br. 67-70; FERC Br. 45-49. As respondents concede (Br. 68), the D.C. Circuit recently sustained the principal regulatory measure adopted by the Commission to reduce pipelines' take-or-pay exposure to producers. *American Gas Ass'n*, slip op. 25-33. Thus, the take-or-pay issue clearly furnishes no basis for invalidating Order No. 451. Contrary to respondents' suggestion (Br. 68), the fact that the Commission has not yet fully resolved the largely separate problem of allocating the take-or-pay costs absorbed by pipelines between the pipelines and their downstream customers, see *Associated Gas Distributors* v. *FERC*, 893 F.2d 349 (D.C. Cir. 1989), cert. denied, No. 89-2016 (Oct. 9, 1990), is irrelevant to the validity of Order No. 451, which principally concerns the upstream relationship between producers and pipelines.

Order No. 451 did not make the take-or-pay problem worse. If what respondents erroneously regard as the one-sided nature of the GFN procedure led a producer not to initiate that procedure with respect to a particular pipeline, then Order No. 451 obviously had no effect on the pipeline's take-or-pay liability to that producer. Conversely, if a producer initiated the GFN process, the pipeline was free to insist upon renegotiation of any take-or-pay contracts with that producer that involved at least some old gas and to terminate the contracts if the producer did not agree. That opportunity can scarcely be said to "exacerbate" the take-or-pay issue (see Resp. Br. 69), and in fact many take-or-pay contracts have been renegotiated as a result of Order No. 451. FERC Br. 47-48. In short, Order No. 451 addressed the take-or-pay issue in an imaginative and effective manner within the scope of the old-gas pricing problem with which it was more immediately concerned.

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Nos. 89-1452, 89-1453

IN THE
Supreme Court of the United States
OCTOBER TERM, 1990

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Petitioners,
v.
UNITED DISTRIBUTION COMPANIES, *et al.*,
Respondents.

FEDERAL ENERGY REGULATORY COMMISSION,
Petitioner,
v.
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On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

BRIEF AMICI CURIAE OF THE STATES OF NEW MEXICO, LOUISIANA, TEXAS, OKLAHOMA, AND WYOMING IN SUPPORT OF PETITIONERS

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QUESTIONS PRESENTED

This brief addresses the following issues:

(1) Whether the Federal Energy Regulatory Commission permissibly interpreted its authority under Sections 104(b)(2) and 106(c) of the Natural Gas Policy Act of 1978 ("NGPA"), 15 U.S.C. §§ 3314(b)(2) and 3316(c), to eliminate "vintaged" ceiling prices for "old" natural gas and establish a single maximum ceiling price for all such gas.

(2) Whether the Commission permissibly interpreted its authority under Section 7(b) of the Natural Gas Act ("NGA"), 15 U.S.C. § 717f(b), to allow abandonment of regulated sales of natural gas by independent producers on a pre-granted basis.

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BRIEF AMICI CURIAE OF THE STATES OF NEW MEXICO, LOUISIANA, TEXAS, OKLAHOMA, AND WYOMING IN SUPPORT OF PETITIONERS

INTRODUCTION

The States of New Mexico, Louisiana, Texas, Oklahoma and Wyoming submit this brief in support of the Federal Energy Regulatory Commission and the Mobil Oil Exploration and Producing Southeast, Inc. parties. The decision of the Fifth Circuit in *Mobil Oil Exploration and Producing Southeast, Inc.* v. *Federal Energy Regulatory Commission*, 885 F.2d 209 (1989), should be reversed.

INTEREST OF THE AMICI CURIAE

The *amici* states submit this brief as *amici* curiae in support of the petitioners in this case, the Solicitor General on behalf of the Federal Energy Regulatory Commission ("Commission") and Mobil Oil Exploration and Producing Southeast Inc. *et al.* ("Producers"). The Commission and the Producers seek reversal of the decision of the United States Court of Appeals for the Fifth Circuit in *Mobil Oil Exploration and Producing Southeast Inc.* v. *FERC*, 885 F.2d 209 (5th Cir. 1989).[1] The *amici* states, individually and collectively, have a vital interest in the questions presented by this case, which revolve around a common issue: in enacting the NGPA, to what extent did Congress intend to grant the Commission discretion to raise the ceiling price for some "old" gas, in order to eliminate distortions in the natural gas market, and to permit market forces to play a greater role in the regulation of sales of natural gas in interstate commerce? In the NGPA, Congress expressed a preference for the operation of market forces to play a significant role in the regulation of producer sales of natural gas; at the same time, Congress retained comprehensive regulation of interstate pipeline sales and service, in recognition of the pipelines' inherent monopoly characteristics.

Much of the natural gas produced and sold in the United States is produced from the *amici* states. Much of the *amici* states' production occurs from state lands. The *amici* states are responsible for the management of the state lands, and in particular the natural resources, including natural gas, that underlie those lands. The *amici* states all have the responsibility, under state laws, to prevent waste, protect the correlative rights of mineral interests owners, and promote the orderly development of production. Although the natural gas industry is subject

[1] This brief of amici curiae is filed pursuant to Rule 37.5 of the Rules of the Supreme Court.

to federal regulation under both the NGA and the NGPA, both of these statutes exempt the "production and gathering" of natural gas under Section 1(b) of the NGA, 15 U.S.C. § 717(b). This Court has held that Section 1(b) reserves to the states the authority to enact laws and regulations aimed at the prevention of waste and the protection of correlative rights. *Northwest Central Pipeline Corporation* v. *State Corporation Commission of Kansas*, 109 S.Ct. 1262 (1988); *Transcontinental Gas Pipe Line Corporation* v. *State Oil and Gas Board of Mississippi*, 474 U.S. 409 (1986). In addition, as royalty owners, the *amici* states are responsible for recovering the maximum amount of natural gas possible from state lands, at the full value of that gas. Moreover, as taxing authorities, the *amici* states are responsible for ensuring the full recovery of all gas produced within the state, whether or not from state lands, and the full value of the gas produced in the states.

The Commission issued Order No. 451 in 1986 to remedy the severely distorted pricing structure that resulted from the "old" natural gas vintaging. By the time the Commission issued Order No. 451, this distorted pricing structure had contributed to the emergence of contract disputes between producers and pipelines over pricing and take requirements on virtually an industry-wide basis. Order No. 451 collapsed the sixteen existing "vintages" for "old" gas, and established a single "alternative" ceiling price for such "old" gas equal to the highest price ceiling among the vintages. Under Order No. 451, producers are not automatically entitled to the alternative maximum lawful price. Producers under specified contracts simply are eligible to collect *up to* that ceiling price, further contingent upon agreement by the purchasers or compliance with a "Good Faith Negotiation" ("GFN") procedure set forth in the order and codified in the regulations. Among other things, as part of the GFN procedure, producers must offer to reduce the

price of "new," generally higher-cost natural gas sold under the same contracts as old natural gas. By so limiting the producers' ability to collect higher prices for old gas, the Commission sought to balance the bargaining positions of gas producers vis-a-vis the interstate pipelines. Through this balance, the Commission sought to avoid dramatic disruptions to the marketplace and to encourage production of low-cost gas.

Industry data suggest that this balancing has worked. The Commission has indicated that gas producers and pipelines have renegotiated thousands of natural gas contracts under Order No. 451. Some of these renegotiations include omnibus settlement of contract liability between producers and pipelines, ending disputes that have dragged on for the better part of a decade. In many instances, gas under those contracts was repriced to reduce the price of some categories of gas at the same time some old gas prices increased. Order No. 451 provided many smaller producers, who typically do not have the leverage necessary to bargain successfully with a major interstate pipeline, with an important bargaining chip that enabled them to obtain release of captive "old gas." Data also indicate that since Order No. 451 has been in effect, natural gas prices at the wellhead have declined. The Energy Information Administration, U.S. Department of Energy, reported that the average wellhead price for natural gas based on available data has declined from $1.94 per Mcf in 1986, the year Order No. 451 became effective, to $1.71 in 1989. Energy Information Administration, *Natural Gas Monthly*, March, 1990 (DOE/EIA-0130 (90/03)), at 32. Duing the same period, total dry gas production increased from 16.536 Tcf to 17.102 Tcf,[2] and consumption increased from 16.221 Tcf to 18.956 Tcf.[3]

[2] *Id.*, at 28.

[3] *Id.*, at 30.

Order No. 451 is critically important to the *amici* states.[4] It permits increases in and rationalizes old gas prices and provides authority for the release and resale of old gas to new markets. Order No. 451 has encouraged the production of old gas, which prevents the permanent loss of the old, low-cost gas. Additional production in turn increases the royalty and tax revenues from such gas. Although Order No. 451 also decreases the prices for new gas, which in turn reduces the royalty and tax revenues on sale of such gas, the *amici* states supports the Commission's goal of relieving the price distortions inherent in old gas vintaging. Ultimately, the *amici* states believe that Order No. 451 will result in vastly enhanced recovery of inexpensive and nonrenewable gas, which will benefit the *amici* states, consumers, the Nation's economy as a whole and the environment.

The Fifth Circuit's decision creates the potential for continuing fiscal uncertainty and tremendous administrative burdens for the *amici* states, as well as dramatic disruption to gas markets. Order No. 451 took effect on July 30, 1986, over four years ago, and has been effective continuously ever since. Although precise figures are not

[4] As Justice Douglas commented in his dissenting ouinion in *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968), the first of several opinions by this Court on review of experiments by the Federal Power Commission to set producer rates following this Court's decision in Phillips Petroleum Co. v. Wisconsin, 347 U.S. 672 (1954):

> Now that *Phillips* has put the prices of producers under federal control, the interests of the producing States must be considered, appraised and weighed as an important ingredient of the "public interest." Regulation of wellhead prices by the Commission directly influences the level and feasibility of production, and can significantly affect the producing States' regulation of production. See Phillips Petroleum Co. v. Wisconsin, *supra*, at 689-690 (dissenting opinion).

Permian Basin Area Rate Cases, *supra*, 390 U.S. at 747 (Douglas, J., dissenting).

available, industry sources have estimated that producers and pipelines have renegotiated thousands of gas sales contracts covering hundreds of millions of dollars in accrued liability under Order No. 451.[5] In addition, a significant spot market for short-term sales of gas has developed over the past few years, in part as a result of the Commission's efforts to restructure the industry. Much old gas was "released," either permanently or temporarily, from long-term contracts, and sold on this spot market to new purchasers under "new" (post-July 30, 1986) contracts. Order No. 451 makes such release and resale possible by providing for pregranted abandonment under NGA Section 7(b), 15 U.S.C. § 717(b), of long-term sales of old gas. Old gas sold on the spot market under new contracts is eligible for the alternative price ceiling established in Order No. 451.

In general, the *amici* states collect royalty based on the value of the natural gas produced from state lands, and severance taxes based on the value of all wellhead sales of natural gas within the states. Since Order No. 451 took effect, the prices of "old" natural gas have increased, approximately to the spot market price level, not the "alternative" ceiling established by the Commission. At the same time, new gas prices have declined, in part as a result of Order No. 451.[6] The reversal of Order No. 451 could cause a fiscal crisis for the *amici* states. The administrative burdens on the states to even calculate the royalty and tax revenues attributable to Order No. 451

[5] Order No. 451 does not require producers and pipelines to utilize the GFN procedure to renegotiate contracts. Indeed, in Order No. 451, the Commission delayed the effective date for commencement of the GFN procedure until November 1, 1986, to allow parties to attempt renegotiation outside of the GFN procedure. Order No. 451, *mimeo* at 45; R. 5437. Although the *amici* states' information is largely anecdotal, it appears that the GFN procedure was invoked only in the minority of renegotiations.

[6] EIA, *Natural Gas Monthly*, March, 1990, *cited supra*, at 35-36.

are immense. In addition, the invalidation of Order No. 451 raises the specter of "shut in" production, and the loss of trillions of cubic feet of natural gas underlying state lands because the production is no longer economically viable.

Perhaps more fundamentally, the *amici* states are concerned about the implications of the Fifth Circuit's decision for the Commission's largely successful initial efforts at restructuring the natural gas industry to respond to the dramatic changes the industry has undergone since the enactment of NGPA. Over the past five years, as this restructuring has occurred, consumers have benefitted from more-than-adequate supplies at ever-lower prices. The Fifth Circuit's decision would not only remove a vital component of the restructuring at a critical turning point in the modern history of the gas industry; the implications of the decision may undermine the Commission's efforts in other regulations to respond to the new market forces. This case raises fundamental questions with respect to the Commission's role in regulating the natural gas industry under both the Natural Gas Act and the NGPA.

SUMMARY OF ARGUMENT

1. The NGPA authorized the Commission to promulgate Order No. 451. 15 U.S.C. § 3314(b)(2); 15 U.S.C. § 3316(c). Not only does the NGPA provide, in plain terms, authority for the Commission to increase old gas prices by rule or order; the NGPA represents a Congressional compromise between competing regulatory philosophies. Congress intended that under the NGPA, the Commission would seek to channel market forces to address the market disruptions that had occurred under traditional utility-type regulation of producers. Order No. 451 is an inevitable outgrowth of that intent. Significantly, almost three years to the day after Order No. 451 became effective, the Congress enacted legislation which will

completely decontrol all gas subject to the orders on review by 1993. Natural Gas Wellhead Decontrol Act of 1989, Pub. L. No. 101-60; 103 Stat. 157; 15 U.S.C. §§ 3331(f), 3431(a)(1)(E). In enacting this legislation, Congress did *nothing* to disturb Order No. 451; indeed, Congress' decontrol of all gas subject to the rule implicitly sanctions the rule.

2. The same legal standards and basic logic apply to the component of Order No. 451 that authorizes pregranted abandonment under Section 7(b) of the NGA. Contrary to the Fifth Circuit's decision, pregranted abandonment does not contradict prior decisions of this Court. Moreover, pregranted abandonment is essential for effective use of market forces following enactment of the NGPA. The Congress expressly intended that the NGPA would limit the Commission's NGA authority over producer sales of gas, as well as prior decisions of the Court. The Fifth Circuit's decision to limit the Commission's flexibility to grant abandonment under the NGA contradicts the intent of Congress under the NGPA and undermines the Commission's authority to restructure the industry to achieve the goals established by Congress in the NGPA. The 1989 Act, cited above, eliminates service controls over old gas effective January 1, 1993.

ARGUMENT

I. THE CONGRESSIONAL INTENT UNDERLYING THE NGPA SUPPORTS ELIMINATION OF VINTAGING.

The NGPA embodies "[t]wo conflicting legislative resolutions" to the natural gas shortages that developed in the 1970s in the interstate market. *FERC* v. *Martin Exploration Management Company*, 486 U.S. 204, 207 (1988). Under the NGA, 15 U.S.C. §§ 717, *et seq.*, the Commission's authority extended over all producer sales for resale in interstate commerce. The NGPA was enacted in 1978, after an acute shortage of natural gas during the 1970s prompted Congress to revise the statutory scheme. "To encourage production, the NGPA took wellhead sales of 'new' and 'high-cost' gas outside the coverage of the NGA . . . and provided instead for market-driven wellhead pricing, at first up to a ceiling, and later with no ceiling." *Northwest Central*, 109 S.Ct. 1262, 1269. Old gas, dedicated to interstate commerce prior to enactment, was to remain forever subject to price and service controls.[7] The Congress sought to eliminate price controls for future production of natural gas to provide an incentive to stimulate needed production, based on Congress' recognition that market incentives were more effective than regulatory rate-setting to bring forth such supplies. Congress also provided in the NGPA for the elimination of the differentials between the interstate and intrastate markets, by creating a single federal pricing scheme for interstate and intrastate gas, and eliminating barriers to transportation and sales between intrastate and interstate commerce.[8]

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[7] Under the Natural Gas Wellhead Decontrol Act of 1989, 15 U.S.C. §§ 3331(f), 3431(a)(1)(E), NGPA price ceilings and NGA certificate and abandonment requirements for old gas are now in the process of being phased out as well, with complete elimination of all wellhead price and service controls effective January 1, 1993.

[8] *See* NGPA Sections 105 and 106(b), respectively, 15 U.S.C. §§ 3315 and 3316(b), and Section 311, 15 U.S.C. § 3371.

1. Since enactment of the NGPA, the Commission has pursued policies that attempt to achieve the goals of the NGPA and respond to evolving market conditions. This has proven a challenging task because of rapid and substantial changes in the industry. The record in this proceeding and numerous studies have documented the sudden emergence, after enactment of the NGPA, of a substantial oversupply of nautral gas (the "gas bubble"). This gas bubble created pressure, both on producers and pipelines, to retrieve markets lost to natural gas during the shortage years of the 1970s and to locate new markets. The Commission worked to facilitate those efforts, in part to protect consumers from large rate increases that would result from the potentially burgeoning liability of some major interstate pipelines to their producer-sellers,[9] and in part because such efforts exploited market forces, consistent with the NGPA.[10]

a. Order No. 451 is one of several rulemaking orders in which the Commission sought, within the limits of its statutory authority, to effectively respond to the

[9] As this Court noted in *Martin Exploration, supra*, many of the interstate sales contracts between producers and pipelines in effect at the time of the NGPA contained pricing provisions that authorized the producer to collect the applicable NGPA ceiling price for any new gas produced under the contract after enactment. *Martin Exploration*, 486 U.S. at 210. Even as production of gas increased rapidly in response to enactment of NGPA, the ceiling prices continued to increase with inflation, until the ceilings were far in excess of realistic then-current market levels. This development was aggravated by "take-or-pay" clauses in these contracts, which require the purchasing pipeline "either to purchase a specified percentage of the producer's deliverable gas or to make 'prepayments' for that percentage anyway." Associated Gas Distributors v. FERC, 824 F.2d 981, 1021 (D.C. Cir. 1987), *cert. denied*, 108 S.Ct. 1468 (1988); *see also*, Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Board, 474 U.S. 409, 412 (1986).

[10] Order No. 451, *mimeo* at 74; R. 5466. *See, generally*, Pierce, *Reconstituting the Natural Gas Industry From Wellhead To Burnertip*, 9 Energy L.J. 1 (1988).

changes in the industry brought about by enactment of the NGPA. In the Commission's Order No. 436, issued in 1985, the Commission established an "open-access" blanket natural gas transportation program, under which interstate pipelines may apply for and receive blanket certificates to transport gas for others.[11] In Order No. 490, issued in 1988, the Commission established a pregranted abandonment rule, by which producers may abandon sales to interstate pipelines and sell that gas to others without the need to seek individual prior approvals.[12] The conceptual underpinnings of these programs had evolved over a considerably longer time, on an individual company basis.[13]

[11] Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, FERC Stats. and Regs. [1982-1985 Regs. Preambles] (CCH) ¶ 30,665, 50 *Fed. Reg.* 42408 (October 18, 1985) (Order No. 436), *on rehearing*, FERC Stats. and Regs. [1982-1985 Regs. Preambles] (CCH) ¶ 30,675, 50 *Fed. Reg.* 52217 (December 23, 1985) (Order No. 436-A), *on rehearing*, III FERC Stats. and Regs. ¶ 30,688, 51 *Fed. Reg.* 6398 (February 24, 1986) (Order No. 436-B), *vacated and remanded*, Associated Gas Distributors v. FERC, 824 F.2d 981 (D.C. Cir. 1987), *cert. denied sub nom.* Southern California Gas Company v. FERC, 108 S.Ct. 1468 (1988); *on remand*, Regulation of Interstate Pipelines After Partial Wellhead Decontrol, III FERC Stats. and Regs. ¶ 30,761, 52 *Fed. Reg.*, 30334 (August 14, 1987) (Order No. 500), *on rehearing*, III FERC ¶ 30,772, 52 *Fed. Reg.* 39630 (October 23, 1987) (Order No. 500-B), *vacated and remanded*, American Gas Association v. FERC, 888 F.2d 136 (D.C. Cir. 1989), *on remand*, III FERC ¶ 30,867, 54 *Fed. Reg.* 52344 (December 21, 1989), *on rehearing*, III FERC ¶ 30,880, 55 *Fed. Reg.* 6605 (February 26, 1990), *review pending*, American Gas Association v. FERC, No. 87-1588 (D.C. Cir., Argued May 8, 1990).

[12] Abandonment of Sales and Purchases of Natural Gas Under Expired, Terminated or Modified Contracts, III FERC Stats. and Regs. ¶ 30,797, 53 *Fed. Reg.* 4121 (February 12, 1988) (Order No. 490), *reh'g denied and clarified*, III FERC ¶ 30,825, 53 *Fed. Reg.* 29002 (August 2, 1988) (Order No. 490-A), *review pending*, Marathon Oil Company v. FERC, No. 88-3666 (6th Cir., filed July 26, 1988).

[13] *See e.g.*, Maryland People's Counsel v. FERC, 761 F.2d 768 (D.C. Cir. 1985); Maryland People's Counsel v. FERC, 765 F.2d 450

b. The Commission's regulatory restructuring has adapted to the transformation that the gas industry has undergone over the past decade. In 1978, virtually all natural gas sold in interstate commerce was sold by producers to pipelines for resale under long-term contracts, priced at federally-established ceilings. Today, the overwhelming majority of natural gas is sold directly by producers to local utilities and end-users under short-term contracts. The pipeline functions primarily as a transporter only, not a merchant middleman as in the past. A flourishing spot market now exists, in which gas prices and service are determined by competing fuels, including competition between natural gas supplies. As data compiled by the Energy Information Administration shows, consumers have benefitted from all of these developments. Prices at the wellhead have declined steadily throughout this period, and these declines have been reflected at the "burner tip," or point of consumption.

Order No. 451 is an essential component and a logical progression in the Commission's restructuring program. With the second phase of wellhead decontrol under the NGPA effective on January 1, 1985, approximately fifty percent of all volumes of gas sold at the wellhead were price-decontrolled. By collapsing the vintages of old gas, the Commission sought to rationalize the pricing structure, and by doing so, to encourage the production of old, low-cost gas. Further, by allowing for pregranted abandonment upon termination of sales (either by settlement or utilization of the GFN procedure), the Commission provided both producers and pipelines needed flexibility to escape long-term contracts that no longer functioned effectively. Order No. 451, *mimeo* at 147-149; R. 5539-5541.

c. Viewed in the context of the Commission's other regulatory initiatives and the record developed by the

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(D.C. Cir. 1985); Kansas Power & Light Co. v. FERC, 851 F.2d 1479 (D.C. Cir. 1988).

Commission in the Order No. 451 proceeding, the determination to eliminate vintaging is amply supported. The Commission's fundamental duty is to ensure adequate supplies of natural gas at just and reasonable prices. The enactment of the NGPA reflects recognition by Congress that market forces provide an effective incentive to producers to stimulate supply development. In eliminating vintaging, the Commission considered the effects of the surplus and the Commission's open-access policy on newer "high-cost" natural gas. Under the NGPA, old, low-cost gas was shut-in. Pipelines took new gas in preference, largely because of take requirements. Thus, the fact that "old" gas was low-priced was not serving the interests of consumers; much old gas was not moving in interstate commerce, and was in danger of permanent loss.

Based upon these findings and the Commission's objectives, Order No. 451 sought to rationalize the marketplace by eliminating vintaging and establishing a single maximum lawful price for old gas. The Commission found, based on data in the record, that a higher maximum lawful price was necessary in order to avoid the irretrievable loss of up to 11 Tcf of old gas, equal more than half of all domestic production for a full year. Order No. 451, *mimeo* at 115, R. 5507; 126, R. 5518; 131, R. 5523. As stated in the introductory section, the *amici* states have an interest in avoiding the loss of gas underlying state lands, and lands subject to taxation and regulation by the state.

2. In order for interstate pipelines to husband indefinitely their contracted supplies of less-expensive gas, it is often necessary to reduce takes dramatically, or shut-in the supplies completely. Shut-in can lead to drainage, as the gas migrates to other wells (which might not be Section 104 gas wells), or loss altogether as the gas bearing formations fill with water or some other substance that makes extraction prohibitively expensive, or impossible. In Order No. 451 and orders preceding

Order No. 451, the Commission determined that promoting recovery of this old gas, even at prices higher than the original vintage prices, was necessitated by the NGA's requirement that the Commission ensure development of adequate supplies at the just and reasonable prices. As stated, above, data generated by EIA have borne out the correctness of the Commission's analysis.

3. The alternative maximum lawful price established by the Commission is just and reasonable under the NGA, and within the Commission's authority under NGPA Sections 104(b)(2) and 106(c). The Fifth Circuit and the opponents of Order No. 451 have made much of the argument that prior to Order No. 451, the Commission had never before applied replacement cost methodology in setting ceiling prices for "flowing gas" from wells already drilled and completed. The opponents overlook several key points. First, even accepting, *arguendo*, that Congress did not intend to authorize a generic elimination of vintaging, Congress did not lock the precise vintages in existence in 1978 into stone in the NGPA. To conclude that the vintages are inviolate reads Sections 104(b)(2) and 106(c) out of the NGPA. As a general matter, statutes must be read to give harmonious meaning and effect to all provisions. *Reiter* v. *Sonotone Corp.*, 442 U.S. 330, 339 (1979).

Second, the history of vintaging contradicts any claim that the methodology could not be experimented with in changed circumstances. As this Court stated in *Permian Basin Area Rate Cases*, which affirmed the Commission's abandonment of individual company unit cost computations in favor of area rate proceedings, "the Commission is not . . . forbidden 'to adapt [its] rules and practices to the Nation's changing needs in a volatile, changing economy.'" 390 U.S. at 759, *quoting American Trucking Association* v. *Atchison, Topeka & Santa Fe Railroad Company*, 387 U.S. 397, 416 (1967). On its face, the NGPA not only authorizes but requires the Commission to reassess old gas prices in the dramatically changed

gas industry of the 1980s. Seen in context, the Commission's actions are amply supported by the NGPA.

4. Congress has not intervened to "correct" Order No. 451, despite the opportunity; Order No. 451 has been effective for four years. Congress' only action on wellhead pricing during this time period was enactment of the Natural Gas Wellhead Decontrol Act of 1989 (the "1989 Act"). The 1989 Act eliminates all wellhead pricing and service obligations as of January 1, 1993, and provides for interim wellhead decontrol between July 26, 1989, and January 1, 1993, for certain categories of old gas.[14] This Court has held that "the construction of a statute by those charged with its execution should be followed unless there are compelling indications that it is wrong, *especially when Congress has refused to alter the administrative construction.*" *CBS, Inc.* v. *FCC*, 453 U.S. 367 (1981) (emphasis added), *quoting Red Lion Broadcasting Co.* v. *FCC*, 395 U.S. 367, 381 (1969) (footnotes omitted); *Zemel* v. *Rusk*, 381 U.S. 1, 11 (1965). Deference to an agency's interpretation of the statute it is charged to implement "is particularly appropriate where . . . [the] agency's interpretation involves issues of considerable public controversy, *and Congress has not acted to correct any misperception of its statutory objectives.*" *CBS*, 453 U.S. at 382 (emphasis added), *quoting United States* v. *Rutherford*, 442 U.S. 544, 554 (1979).

In enacting the 1989 Act, the Congress expressly acknowledged the promulgation of Order No. 451 three

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[14] Specifically, Section 2(a) of the 1989 Act eliminates price and service controls over first sales prior to January 1, 1993, for: (1) gas as to which no first sales contract applies on the date of enactment (July 26, 1989); (2) gas under existing contracts, as those contracts expire or are terminated; and (3) gas under existing contracts that the parties renegotiate, after March 23, 1989, to provide that the gas will not be subject to any maximum lawful price. 15 U.S.C. § 3331(f). In addition, gas produced from wells newly-spudded after July 26, 1989, the date of enactment, is deregulated effective May 15, 1991.

years earlier. The Senate Report noted with approval Commission initiatives, including Order No. 451, that, along with court decisions and market pressures, "have stimplated competition in the natural gas pipeline industry that has created opportunities for all classes of natural gas consumers to share in the benefits of the decline in wellhead prices." S.Rep. No. 39, 101st Cong., 1st Sess. 6-7 (1989). The House Report, while not specifically identifying any Commission policy, contains a similar statement. H.R.Rep. No. 29, 101st Cong., 1st Sess. 6 (1989). Although the Court is "chary of attributing significance to Congress' failure to act, a refusal by Congress to overrule an agency's construction of legislation is at least some evidence of the reasonableness of that construction, particularly where the administrative construction has been brought to Congress' attention through legislation specifically designed to supplant it." *United States* v. *Riverside Bayview Homes*, 474 U.S. 121, 137 (1985). Rather than attempting to supplant the Commission's interpretation of the NGPA, the 1989 Act implicitly *endorsed* Order No. 451, taking the final step toward application of market forces to old gas pricing.

5. Finally, the Commission does not permit producers to collect the alternative maximum lawful price absent a voluntary renegotiation or utilization of the GFN procedure, to ensure that the renegotiated price would not exceed market price *or* replacement cost levels, whichever is *lower*. Order No. 451, *mimeo* at 113; R. 5505. Moreover, the alternative maximum lawful price ceiling itself was codified in the NGPA as an old gas price. That price, $2.57 per MMBtu in July, 1986, and $2.98 per MMBtu in July, 1990, is well above the spot market price.[15] The contracts affected by Order No. 451 did not

[15] The Senate Report on the 1989 Act stated that average wellhead prices had declined from $2.66 per Mcf in 1984 to $1.70 in 1988. The average wellhead price would include long-term contract prices as well. The long-term prices tend on average to be *higher* than spot market prices. Thus, if anything, the $1.70 figure is probably inflated. According to EIA's March 1990 Natural Gas Monthly, the annual average was $1.68 per Mcf in 1988, and $1.71 in 1989. In 1989, according to EIA, the average price for old gas was $1.69. *Id.*, at 34. The average price of "new gas" was $2.46 per Mcf. *Id.*, at 35.

automatically authorize collection of the alternative price. This Court has recognized the difference between deregulated sales and sales subject to continued price controls that exceed current market levels. *See Martin Exploration Management Co.*, 486 U.S. at 209-211. However, the Commission based its rule on a reasonable reading of the NGA and NGPA, evolution over several decades of the "just and reasonable" concept, and studies in the record showing a tremendous loss of old gas even at the alternative ceiling price established by the Commission.[16]

II. THE ABANDONMENT PROVISION IS CONSISTENT WITH THE NGA AND THE NGPA, AND THE COMMISSION'S EVOLVING ABANDONMENT POLICY.

As with the alternative maximum lawful price ceiling, Order No. 451's abandonment provision represents an evolving policy favoring the use of market forces to regulate service. The Commission's decision to permit pregranted abandonment for contracts terminated under the rule is supported by the NGA and the NGPA, relevant decisions and the record.

The same market conditions that forced a re-examination of vintaging compelled the Commission to re-examine its abandonment policy under NGA Section 7(b). Before the market dislocations of the 1980s, the Commission em-

[16] In Order No. 451, the Commission acknowledges that "there can be no guarantee that the post-1974 price will remain market responsive . . . . the action taken in this rule represents a pragmaitc approach." Thus, the Commission foresaw the possibility that market prices might rise above the post-1974 rate. Order No. 451, *mimeo* at 96; R. 5488.

ployed the "comparative needs test" to determine whether to grant an abandonment; the Commission would compare the specific needs of the customers to whom service was to be terminated against the needs of the new proposed customers. In the 1980s, the Commission increasingly found the comparative needs test ill-suited to market conditions. In particular, the evolution of a short-term spot market necessitated a responsive regulatory scheme that would permit abandonment of sales and commencement of new sales without a lengthy regulatory review.[17]

In 1985, the Commission formally modified its abandonment policy in a departure from the "comparative needs test." *Felmont Oil Corp. & Essex Offshore Inc.*, 33 FERC ¶ 61,333 (1985), *reversed and remanded on other grounds, Consolidated Edison Company of New York* v. *FERC*, 823 F.2d 630 (D.C. Cir. 1987), *on remand, Felmont Oil Corp. & Essex Offshore Inc.*, 42 FERC ¶ 61,172 (1988). In *Felmont*, "[i]nstead of comparing the needs of the current consumers against the needs of identified specific new customers, the Commission announced that

[17] In 1983, the Commission began the evolution toward a new standard. In that year, the Commission first authorized special marketing programs ("SMPs"). These programs, issued on a company-by-company basis, provided for "blanket" abandonment, resale and transportation authority under NGA Section 7 for gas voluntarily released by pipelines to be sold to customers capable of switching to another fuel instead of gas. The pipeline would condition releases upon relief from contract take requirements. The programs were limited in duration. The District of Columbia Circuit invalidated and remanded the SMPs, not because of the generic pre-granted abandonment feature, but because the programs discriminated against so-called "captive" customers. Maryland Peoples Counsel v. FERC, 761 F.2d 768, 774 (D.C. Cir. 1985). On remand, the Commission developed its open-access transportation program on a generic basis in Order No. 436. The transportation program did not contain a feature comparable to the SMPs' generic pre-granted abandonment authorization, although the program did provide an expedited procedure for producer abandonment of old gas if the pipeline had substantially reduced its takes without payment. *See* 18 C.F.R. Section 2.77.

it would now compare the needs of the current consumers against the benefit that would accrue to the natural gas market as a whole were the facilities in question released from Commission jurisdiction." *ConEd*, 823 F.2d at 632.[18] In 1988, the Commission issued a generic abandonment rule.[19] The generic abandonment rule permits automatic pregranted abandonment of producer sales to pipelines if the parties mutually agree, the underlying contract has expired, or if the contract can be terminated at the option of one of the parties.

Seen in its proper context, the abandonment provision of Order No. 451 is a logical, incremental extension of the Commission's evolving abandonment policy. During

[18] The Commission quickly adopted the new *Felmont* policy in blanket certificates. These "limited-term abandonment" or "LTA" certificates authorized "the abandonment of sales by producers to pipelines of NGA-jurisdictional gas for a limited period, to the extent that such gas is released from contract by the original pipeline-purchaser. The released gas may then be sold by the producers to third parties on the spot market." Kansas Power & Light Company v. FERC, 851 F.2d 1479, 1482 (D.C. Cir. 1988). LTAs functioned in essentially the same manner as SMPs, except that (1) LTAs did not authorize transportation of the released gas (the Order No. 436 blanket open-access transportation provided the transportation component of the former SMPs) and (2) LTAs contained no customer restrictions.

After initially limiting LTAs to authorize abandonment only for gas priced above the Section 109 price (*i.e.*, Sections 102(d) and 108 gas), *see Tenneco Oil Co.*, 33 FERC ¶ 61,134 (1985), the Commission ultimately approved LTAs that permitted blanket pregranted abandonment of gas in all NGPA price categories, including all Section 104 and 106(a) gas. *See, e.g.*, *Odeco Oil and Gas Co.*, 38 FERC ¶ 61,343, *reh'g denied*, 39 FERC ¶ 61,283 (1987), *aff'd*, KP&L v. FERC, *supra*. The inclusion of Section 104 and 106(a) gas in LTA authority enabled producers to combine the LTA authority with the Order No. 451 regulations to collect up to the Order No. 451 alternative ceiling price for gas released under an LTA, regardless of vintage, under any new contract entered into after July 30, 1988. Order No. 451, mimeo at 76-77, n.128; R. 5468-5469.

[19] Order No. 490, *supra*, n.12.

the initial restructuring in the 1980s, the Commission constantly re-examined its abandonment policy, in light of changes in the industry and careful court review. The Commission concluded in Order No. 451 that if the producer could not secure an adequate price for his old gas, he should be permitted to attempt to secure that price elsewhere, based upon the post-*Felmont* comparative needs analysis. Based on industry conditions, the Commission concluded that the "present" and "future" public convenience and necessity are satisfied by the rule.

As with the price aspects of the rule, Congress' nonintervention in the abandonment provisions of Order No. 451 is significant. The rule has been in effect four years; the Commission first permitted pre-granted abandonment more than seven years ago, in the SMPs; Order No. 490, the generic abandonment rule, has been in effect for more than two years. The 1989 Act provides for price and service controls to terminate as to old gas contracts effective with expiration, termination, or mutual release. In other words, the preconditions to abandonment under Order No. 490 now permit decontrol under the 1989 Act.

CONCLUSION

The Commission acted within the discretion afforded by Congress in enactment of the NGPA. Sections 104(b)(2) and 106(c) convey broad authority to eliminate old gas vintaging and to allow market forces to play a role in the establishment of prices for old gas. Moreover, the abandonment provision of the Natural Gas Act is sufficiently broad to authorize pre-granted abandonment in the manner provided for in Order No. 451.

For the reasons stated above, the Court should reverse the underlying circuit decision.

Respectfully submitted,

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Nos. 89-1452, 89-1453

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

MOBIL OIL EXPLORATION & PRODUCING SOUTHEAST, INC., *et al.*,
Petitioners,
v.
UNITED DISTRIBUTION COMPANIES, *et al.*,
Respondents.

FEDERAL ENERGY REGULATORY COMMISSION,
Petitioners,
v.
UNITED DISTRIBUTION COMPANIES, *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

AMICUS BRIEF OF INTERSTATE OIL COMPACT COMMISSION IN No. 89-1452 IN SUPPORT OF PETITIONERS

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QUESTION PRESENTED

Whether, in the orders on review, the Federal Energy Regulatory Commission acted within its statutory authority and furthered the intent of Congress in the enactment of the Natural Gas Act, 15 U.S.C. § 717 *et seq.*, and the Natural Gas Policy Act of 1978, 15 U.S.C. § 3301 *et seq.*, wherein Congress has expressed strong support for regulatory actions which protect consumers by ensuring an adequate and reliable supply of natural gas at reasonable rates?

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AMICUS BRIEF OF INTERSTATE OIL COMPACT COMMISSION IN No. 89-1452 IN SUPPORT OF PETITIONERS

INTRODUCTION

The Interstate Oil Compact Commission submits this brief in support of the Federal Energy Regulatory Commission and the Mobil Oil Exploration and Producing Southeast, Inc. parties. For the following reasons, the majority decision of the Fifth Circuit in *Mobil Oil Exploration and Producing Southeast, Inc. v. Federal Energy Regulatory Commission*, 885 F.2d 209 (5th Cir.

1989), *cert. granted*, —— U.S. ——, 110 S.Ct. 2585 (1990), should be reversed.

INTEREST OF THE AMICUS CURIAE

The Interstate Compact to Conserve Oil and Gas (the "Compact") is an agreement among oil and gas producing states, originally six in number when first ratified in 1935. It was approved by the Congress in that year and has continued in force since August 27, 1935. Today twenty-nine states are members of the Compact.[1]

Article II of the Interstate Compact to Conserve Oil and Gas, as filed with the National Archives on September 22, 1971, provides:

> The purpose of this Compact is to conserve oil and gas by the prevention of physical waste thereof from any cause.

The Interstate Oil Compact Commission (the "IOCC"), the members of which are the Governors of the signatory states, is the administrative agency that was created by the Compact to carry out its purpose. The IOCC is a multistate governmental entity totally funded from tax revenues.

Historically, the responsibility for oil and gas conservation has vested in and has been exercised by the states, which are the custodians of natural resources within their borders. Indeed, the desirability of state regulation has been recognized by Congress, the Supreme Court of the United States, and numerous agencies and departments of the federal government. *See* Natural Gas Act of 1938 (the "NGA"), § 1(b), 15 U.S.C. § 717(b)

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[1] The following states are members of the Compact: Alabama, Alaska, Arizona, Arkansas, California, Colorado, Illinois, Indiana, Kansas, Kentucky, Louisiana, Maryland, Michigan, Mississippi, Montana, Nebraska, Nevada, New Mexico, New York, North Dakota, Ohio, Oklahoma, Pennsylvania, South Dakota, Texas, Utah, Virginia, West Virginia, and Wyoming. There are also six associate members including Georgia, Idaho, North Carolina, Oregon, South Carolina, and Washington.

(providing that states retain jurisdiction over the production and gathering of natural gas); *Northwest Central Pipeline Corp. v. State Corporation Commission of Kansas*, —— U.S. ——, 109 S.Ct. 1262, 1274 (1989) (Section 1(b) of NGA sufficient to reserve power to states to act to prevent waste and product correlative rights); *F.P.C. v. Panhandle Eastern Pipe Line Co.*, 337 U.S. 498, 509-512 (1949) (legislative history of NGA shows Congress recognized that power to prevent waste is allocated to states). This responsibility reflects the direct, economic, social and vital interest of the states in the conservation of their natural resources.

Order Nos. 451 and 451-A (the "Orders") were promulgated in response to a proposal by the Secretary of Energy to revise old gas prices under the Natural Gas Policy Act of 1978 (the "NGPA"), 15 U.S.C. § 3301 *et seq. Ceiling Prices; Old Gas Pricing Structure*, 50 *Fed. Reg.* 48,540 (1985) (proposed November 25, 1985). A major reason for initiating the rulemaking was the concern that existing prices for natural gas under Sections 104(b)(3) and 106(c) of the NGPA were causing the premature abandonment of many old gas wells, resulting in the permanent loss of substantial old gas reserves. *Id.*, 50 *Fed. Reg.* at 48,540. The Secretary of Energy summarized the old gas pricing problem as follows:

> The existing price structure for old gas creates a barrier against the production of tens of trillions of cubic feet of old gas reserves, even though these reserves are easier and less expensive to produce than other gas sources. The artificially low prices imposed on old gas by the existing price structure prevents [sic] us from producing all our recoverable old gas supplies.

Id.

Because the Orders seek to prevent the premature permanent loss of substantial old gas reserves, the Orders

serve to bolster the conservation efforts of the IOCC and its member states. Those conservation efforts emphasize the prevention of waste through ceiling prices which extend the economic life of wells and permit additional work on older wells to assure maximum recovery of gas reserves.

Several of the individual IOCC member states are submitting a separate brief amici curiae wherein they urge grounds that are beyond the scope of the Compact as bases on which the Orders should be sustained. The IOCC as a whole has directed its Executive Director and General Counsel to submit this brief confined solely to consideration of the validity of the Orders as they pertain to the purpose for which the organization exists: conservation of the nation's oil and natural gas resources by the prevention of their ultimate physical waste. This brief is intended to assist the Court in its resolution of this case, which will have a direct effect on accomplishment of the Compact's stated purpose.

STATEMENT OF THE CASE

The Federal Energy Regulatory Commission (the "FERC" or "Commission") issued Order No. 451 on June 6, 1986. 51 *Fed. Reg.* 22,168 (1986) *reprinted at* III *FERC Statutes and Regulations* ¶ 30,701 (CCH 1986) (hereinafter citations to the Orders will refer to paragraphs and page numbers of the CCH Statutes and Regulations volumes). The FERC denied rehearing of Order No. 451 on December 15, 1986, and issued Order No. 451-A, which made certain revisions and clarifications to the original order. III *FERC Statutes and Regulations* ¶ 30,720.

Before describing the posture of the Order No. 451 litigation today, it is useful to address the state of the natural gas industry which led the DOE to suggest, and the FERC to adopt, the changes made by the Orders. In the early 1970's, it became apparent that the existing

regulatory structure was not working, as the United States was experiencing serious gas shortages. *See Transcontinental Gas Pipeline Corp. v. State Oil and Gas Board of Mississippi*, 474 U.S. 409, 420 (1986). In response to the imbalance between supply and demand the Congress enacted the NGPA, which was designed as a comprehensive statute to govern natural gas regulation. *Id.*, 474 U.S. at 420-21. The statute reflected a recognition that the old system was not working to balance supply and demand, and that a new approach was needed. *Id.*

The NGPA sets varying price ceilings for different categories of gas, depending upon when or how the gas is produced; higher ceiling prices are provided for production of "new", i.e., post-November 9, 1978 gas, or hard to produce gas and lower ceiling prices are provided for gas already in production at the time of the NGPA's passage, known as "old" gas. *See Public Service Commission of the State of New York v. Mid-Louisiana Gas Co.*, 463 U.S. 319, 331-336 (1981) (outlining features of the NGPA). Congress, however, recognized that NGPA ceiling prices might be set too low for "old" gas, and specifically authorized the Commission to raise these prices in accordance with NGA "just and reasonable" principles. *Id.*, 463 U.S. at 333.

The Commission in the Order No. 451 proceeding found that the existing price structure was skewing development and recovery efforts away from old gas, even though that gas is cheaper to produce than new gas. III *FERC Statutes and Regulations* ¶ 30,701 at 30,229. The Commission concluded that elimination of the existing price structure would increase recoverable old gas reserves by approximately 11 trillion cubic feet. *Id.*, ¶ 30,-701 at 30,234. Acting pursuant to its express authority under Sections 104(b)(2) and 106(c) of the NGPA, the FERC established a single ceiling price, or maximum lawful price (the "MLP") applicable to all vintages of old gas. The MLP was set at $2.57 per million Btus ("MMBtu"), which was the existing ceiling price for

the post-1974 gas vintage. *Id.*, ¶ 30,701 at 30,227. The FERC permitted producers to collect this price above the old ceiling *only* if the purchaser—either under its existing contract or in a new, post-Order No. 451 contract—*agreed* to pay a higher price. III *FERC Statutes and Regulations*, ¶ 30,720 at 30,403-30,430 (discussing and modifying Order No. 451 "good faith negotiation" procedure).

On September 15, 1989, a divided panel of the court of appeals vacated the Orders. It held that the Commission had exceeded its authority by collapsing the formerly separate vintage categories into one new ceiling price. *Mobil Oil Exploration*, *supra*, 885 F.2d at 218-221.

SUMMARY OF ARGUMENT

The majority decision of the Fifth Circuit should be reversed. The NGPA explicitly authorizes the Commission to set a ceiling price for old gas as long as that new ceiling price is just and reasonable under the NGA. The Commission has great latitude in its determination of just and reasonable rates as long as the price ceiling serves to assure adequate, reliable supplies of natural gas at reasonable prices. The Commission in its promulgation of the Orders was well within the bounds of its authority as defined by the NGPA,' and well within its purpose and mission as defined by the just and reasonable standard of the NGA.

The IOCC leaves for the parties the main issues of the comprehensive au'hority of the FERC to undertake the Order No. 451 program. As amicus, however, the IOCC emphasizes the issues of the conversation of natural resources and the prevention of waste. These concerns go hand-in-hand with the obligation of the Commission to assure an adequate and reliable supply of gas for the future. The Orders were issued, in part, because the old vintage price ceilings would result in the permanent loss of massive volumes of readily accessible natural gas. This is a fundamental reason why the Order No. 451

program is completely consistent with the NGA and NGPA, which explicitly share the goal of maximizing the utilization of natural resources. These issues, together with the FERC's clear authority to establish just and reasonable ceiling prices under the NGA and NGPA, provide an independent basis upon which the Orders should be affirmed.

ARGUMENT

I. THE NGPA PROVIDES THE COMMISSION WITH AUTHORITY TO RAISE OLD GAS CEILING PRICES TO A SINGLE CEILING PRICE WHICH IS JUST AND REASONABLE.

In NGPA Sections 104 and 106 Congress explicitly authorized the Commission to raise ceiling prices for dedicated gas sales "if such . . . price is . . . just and reasonable within the meaning of the Natural Gas Act". 15 U.S.C. §§ 3314(b)(2)(B) and 3316(c). The statute recognizes that the ceiling may be too low and authorizes the Commission to raise it whenever traditional NGA principles would dictate a higher price. *Public Service Commission of the State of New York*, *supra*, 463 U.S. at 333.

The majority of the Fifth Circuit concluded that Congress did not intend to give the FERC authority in Sections 104(b)(2) and 106(c) to set a *single* ceiling price for all old gas and that the Commission's actions amounted to impermissible *de facto* regulation. *Mobil Oil Exploration*, *supra*, 885 F.2d at 218-220. The majority did not reach the issue of whether the MLP set by the Commission was in fact just and reasonable under the NGA.

The plain language of Sections 104(b)(2) and 106(c) refutes the majority's conclusion regarding the lack of FERC authority to set a single MLP for all old gas and to collapse the vintage pricing structure within that

category. Those provisions allow the Commission by rule or order to set "*a* maximum lawful ceiling price" for any category of old gas. 15 U.S.C. §§ 3314(b)(2), 3316(c) (emphasis added). The *only* constraints which can be fairly read from the NGPA and its legislative history are that the new rate must be just and reasonable under the NGA standard and that it must be higher than the original ceiling set by the NGPA for that category of gas.

II. THE COMMISSION ENJOYS WIDE LATITUDE WITH RESPECT TO THE FACTORS CONSIDERED WHEN SETTING JUST AND REASONABLE RATES.

A. The Commission is Entitled to Considerable Deference in Formulating A Just and Reasonable Rate.

The majority decision below ignores the fundamental principle that the Commission is entitled to considerable latitude when attempting to achieve a legitimate regulatory goal. Indeed, the Commission must be free "to make the pragmatic adjustments which may be called for by particular circumstances." *Permian Basin Area Rate Cases*, 390 U.S. 747, 777 (1968) (quoting *F.P.C. v. Natural Gas Pipeline Co.*, 315 U.S. 575, 586 (1942)). The majority of the Fifth Circuit in this case has improperly second guessed the Commission.

The *only* constraint on the Commission's authority to increase the ceiling price for a category of old gas is the requirement that the resulting ceiling be just and reasonable. In determining whether the Commission has adopted a just and reasonable rate, the reviewing court must be guided not by the methodology employed by the Commission, i.e., replacement cost vs. historical costs,[3]

[3] The Commission patterned its replacement cost methodology on the approach used to determine the last nationwide rate of Opinion No. 770-A for post-1974 gas production. III *FERC Statutes*

but, rather, by the ultimate result of the Commission's action. In other words, as this Court has affirmed, "[u]nder the statutory standard of 'just and reasonable' it is the result reached not the method employed which is controlling." *F.P.C. v. Hope Natural Gas Company*, 320 U.S. 591, 602 (1944). *See also*, *Permian Basin Area Rate Cases*, *supra*, 390 U.S. at 775. As long as the Commission's action is consistent with the controlling statute, as it is in this case, the reviewing court must accord deference to the agency's interpretation. *See K-Mart Corp. v. Cartier*, 486 U.S. 281, 291-92 (1988).

The Commission demonstrated to the Fifth Circuit that it had "given reasoned consideration" to each of the factors pertinent to its decision to use replacement cost as a basis for setting a higher price for old gas. Accordingly, because the Commission has the authority under the NGPA to set a single new just and reasonable rate for old gas, the Commission met its burden on review and the Fifth Circuit's decision should be reversed.

B. The Commission is Free When Formulating a Just and Reasonable Rate Under the NGA to Consider Non-Cost Based Factors.

As discussed, the Commission should be afforded wide latitude when deciding the methodology to employ in formulating a just and reasonable rate under the NGA. This is because the Commission must consider a myriad of factors besides price when setting a just and reason-

and Regulations, ¶ 30,701 at 30,226. Use of this methodology was affirmed in *American Public Gas Ass'n v. F.P.C.*, 567 F.2d 1016 (D.C. Cir. 1977), *cert. denied*, 435 U.S. 907 (1978). The Commission endeavored to accomplish the objective of achieving an adequate supply at reasonable rates by raising the vintage prices equal to the replacement costs of those reserves. III *FERC Statutes and Regulations* ¶ 30,701 at 30,222. Rates established using historical costs, on the other hand, reflect the costs actually incurred in developing the reserves in question generally without regard to the cost in today's dollars of replacing those reserves.

able rate. One such factor is the availability of long-term supplies to consumers. In this case, the Commission decided to use replacement cost pricing to set the MLP at a level that would "put some of the burden of replacing scarce gas supplies on the consumers of flowing gas," and to impose price rationality on the market in an effort to prevent the loss of significant volumes of old, low-cost gas. *Tenneco Oil Company v. FERC*, 571 F.2d 834, 840 (5th Cir. 1978), *cert. dismissed*, 439 U.S. 801 (1978), (*citing Mobil Oil Corp. v. F.P.C.*, 417 U.S. 283, 320 (1974)). *See also American Public Gas Ass'n, supra*, 567 F.2d at 1058. When exploring a particular methodology to establish a just and reasonable rate, the Commission undoubtedly has latitude to consider non-cost based factors, including the goal of increasing supply.[3] *See, e.g., Mobil Oil v. F.P.C., supra*, 417 U.S. at 320-321.

C. The Commission's Consideration of Non-Cost Factors, Particularly Increased Long-Term Supply, is Consistent with Congress' Intent As Reflected in the NGA and NGPA.

As this Court has noted, the Commission fulfills an essential purpose of the NGA when it sets rates to assure that there is "an adequate and reliable supply of gas at reasonable prices." *California v. Southland Royalty Company*, 436 U.S. 519, 523 (1978). Thus, the Commission was well within its regulatory authority under the NGA

[3] The amicus notes that in supporting the goal of maintaining an adequate and reliable supply into the future, the Commission did not sacrifice considerations of the Orders' ultimate effect on prices paid by consumers. The Commission believed that in the long-term the effect of the Orders would be to ensure lower prices. III *FERC Statutes and Regulations*, ¶ 30,701 at 30,236. In fact, the goal of setting realistic, market clearing prices, which encourage competition and increase utilization of natural gas reserves, fits very well with the ultimate goal of lowering the price paid by consumers.

when it considered the replacement cost of old gas and set out to avoid the possible permanent loss of substantial old gas reserves when it established a new MLP for old gas. Indeed, it was obligated to consider the effect of the new rate upon the long-term supply of old gas.

Congress' concern with adequate supplies of natural gas was not limited to the NGA, however. The assurance of adequate supplies was at the heart of the NGPA as well. Indeed, the NGPA was specifically adopted to remedy price disparities between the regulated interstate market and the unregulated intrastate market. Interstate ceiling prices were set at levels considerably below prices for gas in the unregulated intrastate market. This caused disparities characterized by severe supply shortages within the interstate market. In direct response to these shortages, Congress enacted the NGPA. *Transcontinental Gas Pipeline Corp., supra*, 474 U.S. at 420. In so doing, Congress affirmed a fundamental precept of its natural gas regulation: that price should be used to elicit supply. *See Colorado Interstate Gas Co. v. F.P.C.*, 324 U.S. 581, 612 (1945) (concurrence of Justice Jackson); *Placid Oil Company v. F.P.C.*, 483 F.2d 880, 901 (5th Cir. 1973), *aff'd sub nom. Mobil Oil Corp. v. F.P.C.*, 417 U.S. 283 (1974).

Accordingly, in considering the effect the new MLP for old gas would have on the continued long-term availability of those reserves, the Commission was responding directly to Congress' intent expressed in the NGPA that the statute ensure adequate and reliable supplies for consumers. The NGA and NGPA have vested the Commission with wide latitude to address the multitude of considerations which comprise the public interest, both short-term and long-term. The majority decision below has destroyed the Commission's ability to be creative in promoting the public interest under ever-changing market conditions, and therefore it should be reversed.

III. BY LAWFULLY ENCOURAGING INCREASED PRODUCTION OF OLD GAS, THE COMMISSION'S ORDERS FURTHER THE INTEREST OF THE AMICUS IN PREVENTING WASTE.

The natural gas industry is subject to interlocking regulation by both federal and state authorities. *Northwest Central Pipeline Corporation, supra*, 109 S.Ct. at 1271. Federal authorities are, on the one hand, charged with protecting the public interest, which interest includes ensuring adequate and reliable supplies of natural gas. State authorities, on the other hand, have long had the responsibility of protecting the public interest through the prevention of waste of natural resources and the protection of the correlative rights of mineral owners. *Id.*; *Northern Natural Gas Co. v. State Corporation Commission of Kansas*, 372 U.S. 84, 93 (1963); *Thompson v. Consolidated Gas Utilities Corp.*, 300 U.S. 55, 67 (1937); *Champlin Refining Co. v. Corporation Commission of Oklahoma*, 286 U.S. 210, 233-34 (1932).

By fulfilling its legal obligation under the NGA and the NGPA to protect the public interest in adequate and reliable supplies through the prevention of the loss of significant quantities of old, low-priced gas reserves, the Commission also furthered the conservation interests of the states in preventing waste. The Commission's Orders represent examples of the interlocking, and in some cases overlapping, responsibilities of federal and state agencies in the context of natural gas regulation. Absent the Orders, hundreds of old gas wells would be abandoned prematurely by producers because it would be uneconomic to produce their remaining reserves at the price levels available under the vintaging system. The failure to produce these reserves might then result in their permanent loss. The higher prices made possible by the Orders extend the economic limit of production, because a lower volume of gas produced per well will yield sufficient income to exceed a constant operating expense. Hence, there will be a greater volume of ultimate recov-

ery of gas from a well. The availability of higher prices under the Orders also permits an operator to perform reworking operations on a well that is approaching its economic limit. Reworking a well will increase the volume of gas flow and thereby extend its productive life. In many instances such reworking operations would not be economically attractive at the lower vintaged price levels.

Once a well is plugged and abandoned as having become uneconomic, it cannot readily be restored to production should prices later increase. The cost of reentering an abandoned well bore will ordinarily not be economically justified in view of the substantially depleted volume of physically producible gas still available for future recovery.

The Orders would prevent the premature and permanent loss of these old, low-cost, reserves by encouraging their continuing production. This is accomplished by raising the ceiling price of reserves to market clearing levels, meaning that the prices will be freed from the artifically low vintage rates and allowed to rise to the market level as long as the price does not exceed the MLP.

The permanent loss of substantial volumes of old gas reserves, which would undeniably occur absent reversal of the Fifth Circuit's majority decision, would represent waste of substantial proportions, at least 11 trillion cubic feet, according to the record. This represents more than 58 percent of the total United States natural gas consumption in 1989. April 1990 Monthly Energy Review (Energy Information Administration-Department of Energy 1990) at 58. Since the regulation of natural gas prices is clearly a field occupied by Congress, and then delegated to the Commission as Congress deems appropriate, only the Commission can prevent waste by the use of the change in the ceiling price contained in the Orders. Accordingly, the amicus strongly supports the

Commission's action under the Orders since it furthers the mutual interests of the states and the federal government through the use of a mechanism, i.e., price, only available to the federal government.

IV. THE CEILING RATE ESTABLISHED UNDER THE ORDERS SATISFIES THE JUST AND REASONABLE STANDARD OF THE NGA.

Rates are just and reasonable if they are within a "zone of reasonableness", meaning that a rate is neither so excessive as to exploit the consumer nor an unconstitutional confiscation of the property of the regulated entity. *Natural Gas Pipeline Co., supra.* The Commission is afforded considerable latitude in setting just and reasonable rates because the Commission's approach to the public interest must be multifaceted, encompassing many different concerns both existing and foreseeable. *Permian Basin Area Rate Cases, supra,* 390 U.S. at 792 (1968). In promulgating the Orders the Commission was responding to concerns which were both existing and foreseeable.

First, and most important to the IOCC, valuable supplies of inexpensive old gas, under the low-priced ceilings under NGPA Section 104(a), were being inadequately developed or prematurely abandoned. The Commission cited two studies by the Energy Information Administration showing that 1984 proven reserves had fallen to their lowest level since 1979. III *FERC Statutes and Regulations* ¶ 30,701 at 30,208-209. The Commission saw this as a dangerous development which, if not reversed, could result in the diminution of reserves to the point of creating shortages of natural gas. The Commission predicted that raising the ceiling price of these categories of gas (an option specifically provided by Congress) would allow more than 11 trillion cubic feet of additional old gas to be recovered. *Id.*, ¶ 30,701 at 30,229.

Second, the Commission saw that the old pricing system was keeping the price of old gas below the competi-

tive market price. Different sellers (and purchasers) of natural gas had varying access to supplies of low-priced old gas. As a result, they were paying wildly varying prices for gas for reasons wholly unrelated to the value of the gas or the costs of replacing the gas. *Id.*, ¶ 30,701 at 30,204.

These market distortions, which would result in the massive waste of known natural gas reserves, were the reasons the Commission concluded that the old vintaging system should be collapsed and a new overall just and reasonable price formulated. In addition, the Commission was convinced that by allowing prices to be more market responsive, as was intended in the NGPA, *see Transcontinental Pipe Line, supra,* 474 U.S. at 421, overall lower prices would result. III *FERC Statutes and Regulations*, ¶ 30,701 at 30,236.

The Commission decided that the "replacement cost" ratemaking methodology would best serve these goals, as opposed to a historical cost approach. It saw that a competitive wellhead market was intended by Congress in its enactment of the NGPA, and that prices would be expected to recover the cost of providing new gas supplies into the future. *Id.*, ¶ 30,701 at 30,229. This methodology was different from that used to develop the pre-NGPA vintage prices, but the method had been used by the Commission before, and upheld as a methodology which resulted in rates within the zone of reasonableness. *Tenneco Oil Company, supra,* 571 F.2d at 840; *Shell Oil Company v. F.P.C.*, 520 F.2d 1061, 1079 (5th Cir. 1975), *cert. denied*, 426 U.S. 941 (1976).

The replacement cost methodology reflects one of the many concerns of the Commission which the NGA directs it to consider, namely the assurance of an adequate supply of natural gas in the future at a reasonable price. *See Tenneco, supra,* 571 F.2d at 840. Adequate supply is a perfectly permissible, and indeed, an obligatory fac-

tor, to be used in determining a just and reasonable rate. *Mobil Oil Corp., supra*, 417 U.S. at 320-321.

The goals the Commission used in formulating its new "just and reasonable" rate in Order No. 451 are legitimate and long-accepted factors used in setting just and reasonable rates within the industry. As stated, these goals are fully consistent in all particulars with the intent of the NGA and the NGPA.

These goals are in every way consistent with the broad goal of the NGA to assure adequate reliable supplies at reasonable prices. They are also consistent with the more recent goal of the NGPA to allow market forces to increase the efficiency of the natural gas industry generally, and natural gas markets specifically, and ultimately to lower consumer prices.

Because the Orders are entirely consistent with the purposes of the NGA and NGPA, evidence of Congressional intent which would prohibit the Commission's actions under the Orders should be very clear. *See Schultz v. Louisiana Trailer Sales*, 428 F.2d 61, 65 (5th Cir. 1970), *cert. denied*, 400 U.S. 902 (1970) (if a statute is susceptible to more than one construction, it must be given that which will best effect its purpose rather than defeat it). In fact, the plain language of the NGPA makes it clear that the Commission was authorized to effect a new single ceiling price for old gas.

CONCLUSION

For the foregoing reasons, the amicus urges the Court to reverse the decision of the Fifth Circuit.

Respectfully submitted,

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BRIEF OF THE WASHINGTON LEGAL FOUNDATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

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August 9, 1990

QUESTION PRESENTED

Amicus will address the following issue:

Whether the court of appeals improperly relied upon selected portions of the legislative history of the Natural Gas Policy Act of 1978 to override the plain meaning of the statute and set aside action by the Federal Energy Regulatory Commission consolidating all vintages of old gas and establishing a higher ceiling price for the consolidated vintages.

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IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1990

Nos. 89-1452, 89-1453

MOBIL OIL EXPLORATION & PRODUCING SOUTHEAST, INC., *et al.*,
Petitioners,
v.
UNITED DISTRIBUTION COMPANIES, *et al.*,
Respondents.

FEDERAL ENERGY REGULATORY COMMISSION,
Petitioner,
v.
UNITED DISTRIBUTION COMPANIES, *et al.*,
Respondents.

On a Writ of Certiorari to the
United States Court of Appeals
For the Fifth Circuit

BRIEF OF THE WASHINGTON LEGAL FOUNDATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

INTEREST OF THE *AMICUS CURIAE*

The Washington Legal Foundation (WLF) is a national nonprofit public interest law and policy center

with more than 125,000 members and supporters nationwide. WLF engages in litigation and the administrative process in a variety of areas promoting the economic and civil liberties of individuals and businesses.

To this end, WLF has filed briefs *amicus curiae* before this Court in a number of cases. *See, e.g., International Union v. Johnson Controls, cert. granted,* 58 U.S.L.W. 3614 (March 26, 1990); *Ingersoll-Rand Co. v. McClendon, cert. granted,* 58 U.S.L.W. 3657 (April 16, 1990); *Pacific Mutual Life Insurance Company v. Haslip, cert. granted,* 58 U.S.L.W. 3628 (April 2, 1990); *Kansas and Missouri v. Utilicorp United Inc.*, 58 U.S.L.W. 4898 (June 21, 1990); *H.J., Inc. v. Northwestern Bell Telephone Co.*, 109 S.Ct. 2893 (1989); *Tull v. United States*, 481 U.S. 412 (1987); and *Pacific Gas & Electric Co. v. Public Utilities Commission of California*, 475 U.S. 1 (1986).

WLF believes that individuals and businesses are entitled to rely on the plain language of a statute. Legislative history should not be elevated over statutory language when a statute is clear and unambiguous.

Amicus submits this brief in support of Petitioners with the written consent of all parties. The written consents are on file with the Clerk of the Court.

STATEMENT OF THE CASE

Amicus is, in the interest of brevity, providing only a condensed statement of the facts of this case. *Amicus* adopts by reference the statements of facts contained in Petitioners' briefs.

This case concerns the attempt by the Federal Energy Regulatory Commission (Commission) to adopt a rational and efficient procedure for regulating prices of natural gas which was already in production to the interstate market prior to 1977 (hereinafter sometimes referred to as "old" gas). The Natural Gas Policy Act of 1978 (NGPA) gave the Commission the authority to set ceiling prices for old gas, subject to certain restrictions discussed below. The Commission responded three and one-half years ago by issuing Orders No. 451 and 451-A (Order 451). This order collapsed all vintages of pre-1977 gas into a single vintage with a ceiling price set equal to the ceiling price for post-1974 vintage old gas. Order 451 was promulgated as an integral and critical component of a comprehensive package of reform orders and, for that reason, did not directly address the "take or pay" issue which was addressed by Commission Order No. 436. 51 Fed. Reg. 22,174-175, 46,783-784 (1986).

The Commission determined that Order 451 could save 11 trillion cubic feet of natural gas that would otherwise be lost to premature abandonment and could reduce overall prices to consumers. 51 Fed. Reg. at 22,172, 46,766; *see* 51 Fed. Reg. at 22,195-204.

The Commission also determined that Sections 104(b)(2) and 106(c) of the NGPA had given it the clear and unambiguous authority to so modify the ceiling prices of old gas. 51 Fed. Reg. at 22,179; *see also* 51 Fed. Reg. at 22,171, 22,174, 46,764.

After extensive cost studies, hearings, and deliberations, the Commission concluded that the ceiling price for post-1974 gas was a just and reasonable price for all pre-1977 gas since it approximated the replacement cost of the gas, represented the marginal opportunity

cost of using existing gas, and was below the ceiling price of new gas. *See* 51 Fed. Reg. at 22,185, 46,778; 51 Fed. Reg. at 22,187, 46,772.

A divided panel of the Court of Appeals for the 5th Circuit vacated Order 451 on September 15, 1989. The majority held that the Commission had exceeded its statutory authority by setting a ceiling price higher than the then current market price, an act which, in its opinion, amounted to "de facto deregulation." *Mobil Oil v. F.E.R.C.*, 885 F.2d 209, 216 n.15 (5th Cir. 1989). The majority's holding ignored the plain language of Sections 104(b)(2) and 106(c) of the NGPA and accorded no deference to the Commission's interpretation of its mandate. *See Mobil Oil*, 885 F.2d at 218-220. Judge Brown dissented, finding, *inter alia*, that the majority had "[s]ubstitute[d] its own judgment for that of the Commission on what Congress has ordained the Commission may do about the grave problems of the natural gas business." *Mobil Oil*, 885 F.2d at 226.

SUMMARY OF ARGUMENT

Amicus contends that a court reviewing actions of a regulatory agency must adhere to the statutory meaning or the legislative intent of the statute under which the agency has acted. This Court has consistently held that the surest indication of legislative intent is the language the Congress used when it wrote the statute. Other indications of legislative intent may, on occasion, be employed, but none may be used to override the unambiguous meaning of plain words comprising the statute itself.

The majority of the court of appeals chose to disregard the plain language of critical portions of the NGPA and, instead, seized upon disjointed fragments of

legislative history to attribute to Congress an intent absent from the statutory language. *Amicus* submits that the majority below is wrong in its standard of review of Commission action because of the elevation of legislative history over the unambiguous words of the statute in deciding whether the Commission acted within its delegated authority. The elevation of legislative history over statutory language is improper because it is contrary to a multitude of decisions of this Court and principles of statutory construction embraced by the Court from its earliest days.

The majority's elevation of legislative history over statutory language is also improper because it undermines one of the principal obligations of government to its citizens: to provide fair notice and certainty for people and businesses as to the rules of law enacted by the Congress. When the Congress speaks, it speaks through the laws it enacts, and if the language of those laws can be erased or modified by unseen and unknown factors, such as obscure floor remarks buried in the abundant pages of the *Congressional Record*, fair notice and certainty become impossible.

Finally, *amicus* submits that the majority below failed to utilize the appropriate standard of review of agency action by disregarding the two-prong test announced in *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), and carried forward in other decisions of this Court, including *K Mart Corp. v. Cartier, Inc.*, 486 U.S. 281 (1988). The *Chevron* test is clearly applicable to the facts of this case and should have been followed by the court below. Even if the majority below had made an erroneous determination of legislative intent, the second prong of the *Chevron* test would have required that Order 451 be left in place as a reasonable agency

response to a statute the majority would necessarily have had to find ambiguous.

ARGUMENT

I. THE COURT OF APPEALS' USE OF ISOLATED FRAGMENTS OF LEGISLATIVE HISTORY TO DEFEAT THE PLAIN MEANING OF SECTIONS 104(b)(2) AND 106(c) AS A MEANS OF DETERMINING LEGISLATIVE INTENT VIOLATES CONTROLLING PRINCIPLES OF LAW ESTABLISHED BY THIS COURT

Section 104(b)(2) of the Natural Gas Policy Act of 1978, which in all relevant respects is identical to Section 106(c) of the same Act, provides:

> Ceiling prices may be increased if just and reasonable--The Commission may, by rule or order, prescribe a maximum lawful ceiling price, applicable to any first sale of any natural gas (or category thereof, as determined by the Commission) otherwise subject to the preceding provisions of this section, if such price is--
>
> (A) higher than the maximum lawful price which would otherwise be applicable under such provisions; and
>
> (B) just and reasonable within the meaning of the Natural Gas Act.

15 U.S.C. § 3314(b)(2); *see also* 15 U.S.C. § 3316(c).

It is impossible to read the words of the statute in any other way except that Congress delegated to the

Commission the authority to raise the ceiling prices of all vintages of old gas, as long as the new ceiling prices were just and reasonable within the meaning of the Natural Gas Act. In spite of this clear and unambiguous delegation of authority, the majority below held that by "abrogating the vintage pricing structure" for old gas by way of Order 451, "the Commission has exceeded its authority under the NGPA." *Mobil Oil*, 885 F.2d at 220-21.

In the view of the majority below, the scope of the Commission's authority to modify the vintage pricing structure for old gas was established, not by the words Congress wrote into the statute, but by various disjointed fragments of legislative history. The legislative history cited by the majority consists of floor remarks by Senators McIntyre, Jackson, Hart, and Domenici, and Representative Sharp. *Mobil Oil*, 885 F.2d at 218-19. None of the cited floor statements directly addressed the question of whether the NGPA prohibited or intended to prohibit the Commission from raising the ceiling prices for old gas as long as it complied with the requirements of Sections 104(b)(2) and 106(c).[1]

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[1] The majority fails to mention that Senator Domenici submitted a letter to the Commission when the meaning of his quoted statement was put in question advising that his remarks were a response to contentions that old gas was to be deregulated by the NGPA. Senator Domenici further stated that in his view, the Commission had always had and still retains authority over vintaging of old gas. 51 Fed. Reg. at 22,179 (letter to the Commission). The majority's opinion also refers to a law review article for "additional discussion of the legislative history of the NGPA . . . ." *Mobil Oil*, 885 F.2d at 219 n.22. A thorough review of that article fails to disclose any legislative history supporting the majority's decision on this issue. *See* Note, *Legislative History of the Natural Gas Policy Act*, 59 Tex. L. Rev. 101 (1980).

The majority disregarded the plain language of the statute in favor of some scraps of legislative history that, in contradiction of the statute's plain language, "support the conclusion that Congress did not intend for the Commission to abrogate, as Order 451 has done, the NGPA prescribed pricing structure." *Mobil Oil*, 885 F.2d at 219.

It has become increasingly necessary in recent years for courts to interpret or construe legislative enactments. Indeed, statutory construction is now the primary focus of a majority of the cases that come before this Court.[2] As the Congress increasingly relies on administrative agencies to implement and enforce legislation after its enactment, the courts have struggled with the increasing involvement of agencies in construing and interpreting congressional enactments. Through it all, and to this day, the fundamental guiding principle for courts and agencies has been to determine and adhere to the will of Congress as expressed in its written product.[3]

Determination of the will of Congress has often been an exceedingly difficult proposition, and various interpretive principles have been utilized in fluctuating

[2] Speaking of this phenomenon in 1947, Justice Frankfurter commented that cases before this Court "not resting on statutes are reduced almost to zero." Frankfurter, *Some Reflections on the Reading of Statutes*, 47 Colum. L. Rev. 527, 527 (1947). *See also* Sunstein, *Interpreting Statutes in the Regulatory State*, 103 Harv. L. Rev. 405, 408-11 (1989).

[3] "We do not inquire what the legislature meant; we ask only what the statute means." Holmes, *The Theory of Legal Interpretation*, 12 Harv. L. Rev. 417, 419 (1899). *See Griffin v. Oceanic Contractors, Inc.*, 458 U.S. 564, 576 (1982)("It is enough that Congress intended that the language it enacted would be applied as we have applied it. The remedy for any dissatisfaction with the results . . . lies with Congress and not with this Court.").

degrees during the past to achieve that goal, or at least systematize the process by which the goal is pursued.[4] Canons of construction, for example, have enjoyed varying levels of popularity and utilization depending upon the makeup of the Court from time to time. *See* Sunstein, *Interpreting Statutes in the Regulatory State*, 103 Harv. L. Rev. 405, 451-462 (1989).

In the earliest days of the Republic, the Court adhered closely to the so-called "English rule" by determining the will of Congress almost exclusively through the words contained in the statutes passed by Congress. As the regulatory apparatus of government grew, there was a shift toward the use of information from sources other than statutory language to help determine the legislative intent of congressional enactments. These other sources included not only the aid to construction principles and canons of construction previously mentioned, but also legislative history. As used herein, and as generally used, *amicus* submits, "legislative history" means any information or material that originates in the Congress, but is not a part of the statute itself. Committee reports and remarks of senators and representatives on the floor of their respective House of Congress are the most common sources of legislative history.

As legislation has become more complicated and voluminous, there has been an increasing tendency to utilize legislative history for a variety of purposes, not all consistent with or supportive of the legislation to which it is linked. In fact, one author has described the

[4] Holmes, *supra* note 3, at 419. ("the purpose of written instruments is to express some intention or state of mind of those who write them . . . . The question is how far the law ought to go in aid of the writers.").

growth in making legislative history as having generated a "cottage industry."[5]

Just as the making of legislative history has flourished in the legislative process, so has the utilization of it as a source for determining legislative intent in the construction of congressional enactment. *Amicus* submits that this phenomenon has developed into a kind of a game, something akin to an Easter egg hunt where the adults are careful not to hide the eggs too well, otherwise they might never be found. Just as in the typical Easter egg hunt, the objective of making legislative history is not to hide tidbits of legislative history so well that they will never be found, but so that they will be found, and having been, will provide the key to "legislative intent."[6]

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[5] In expressing his view of some of the practical problems flowing from the use of legislative history in statutory construction, Kenneth Starr, then on the bench of the Court of Appeals for the District of Columbia Circuit, observed that: "It is well known that technocrats, lobbyists, and attorneys have created a virtual cottage industry in fashioning legislative history so that the Congress will appear to embrace their particular view in a given statute." Starr, *Observations About the Use of Legislative History*, 1987 Duke L.J. 371, 377 (1987).

[6] Representative Hechler purposely created an example showing how easily legislative history can be created and abused: "Mr. Speaker, having received unanimous consent to extend my remarks in the RECORD, I would like to indicate that I am not really speaking these words. . . . As a matter of fact, I am back in my office typing this out on my own hot little typewriter, . . . Such is the pretense of the House that it would have been easy to just quietly include these remarks in the RECORD, issue a brave press release, and convince thousands of cheering constituents that I was there fighting every step of the way, influencing the course of history in the heat of debate." 117 Cong. Rec. 36,509 (1971) (Statement of Rep. Hechler).

The starting point in the search for legislative intent is in the words of the statute. As Justice Cardozo put it so well and so succinctly in describing the proper role of this Court in construing statutes: "We do not pause to consider whether a statute differently conceived and framed would yield results more consonant with fairness and reason. We take this statute as we find it." *Anderson v. Wilson*, 289 U.S. 20, 27 (1933). And, as Justice Frankfurter observed, "While courts are no longer confined to the language, they are still confined by it. Violence must not be done to the words chosen by the legislature." Frankfurter, *Some Reflections on the Reading of Statutes*, 47 Colum. L. Rev. 527, 543 (1947). *See Consumer Product Safety Comm'n v. GTE Sylvania, Inc.*, 447 U.S. 102 (1980).

This Court has held that when free from ambiguity, the words of the statute must control over other proposed interpretations based on extraneous indications of legislative intent. "We think that the 'fragments of legislative history' on which . . . the Court of Appeals relied do not constitute 'a clearly expressed legislative intent contrary to the plain language of the statute.'" *United States v. James*, 478 U.S. 597 (1986), quoting *American Tobacco Co. v. Patterson*, 456 U.S. 63, 75 (1982); *see Consumer Product Safety Comm'n v. GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980).

This rule of plain meaning was rejected by the majority below and in its rightful place, as the primary determinant of legislative intent, the majority chose an exceedingly poor substitute -- remarks by four different senators and one representative during floor debate on the bills which became the NGPA.

We submit that the issue is not simply an academic debate concerning the primacy of various sources of

legislative intent, based on whether the source is included in the formal language of a statute. At bottom, the issue is one of adherence to the constitutionally mandated division of authority and responsibility between the branches of government. The creation of statutes is the function of the legislative branch, not the judicial branch.[7] A court crosses the Constitutional line between enacting and interpreting when, under the guise of a "search for meaning," it divines the will of Congress not in the words of the statute but in scattered fragments called "legislative history." And, when the Congress has spoken, the courts are not free to change the law by interpretation. Only the Congress may change the law.[8]

In the instant case, the majority below usurped the legislature's assigned role by concluding, in contradiction to Congress' own enacted words, that four senators and one representative spoke for the entire Congress. In effect, the majority set itself up as a two-member

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[7] Justice Frankfurter perhaps best articulated this principle: "But there are more fundamental objections to loose judicial reading. In a democracy the legislative impulse and its expression should come from those popularly chosen to legislate, and equipped to devise policy, as courts are not. The pressure on legislatures to discharge their responsibility with care, understanding and imagination should be stiffened, not relaxed. Above all, they must not be encouraged in irresponsible or undisciplined use of language. In the keeping of legislatures perhaps more than any other group is the well-being of their fellow man. Their responsibility is discharged ultimately by words." Frankfurter, *supra* note 2, at 545-546.

[8] *United States v. James*, 478 U.S. 597, 612 (1986) ("[O]ur role is to effectuate Congress' intent. . . . If that provision is to be changed, it should be by Congress and not by this Court."); *United States v. Locke*, 471 U.S. 84, 95 (1985) ("Nor is the Judiciary licensed to attempt to soften the clear import of Congress' chosen words whenever a court believes those words lead to a harsh result.").

superlegislature and passed a new and different law with respect to the authority of the Commission to collapse the vintages of old gas and set a higher regulated price for such gas. The use by the majority below of wisps of legislative history to override the plain language of Sections 104(b)(2) and 106(c) is a violation of the controlling legal principles and precedents. Such action must be overruled. *United States v. James*, 478 U.S. 597 (1986); *American Tobacco Co. v. Patterson*, 456 U.S. 63 (1982); *Rubin v. United States*, 449 U.S. 424 (1981); *Consumer Product Safety Comm'n v. GTE Sylvania, Inc.*, 447 U.S. 102 (1980).

II. THE COURT OF APPEALS' IMPROPER RELIANCE UPON PORTIONS OF THE NGPA'S LEGISLATIVE HISTORY TO VACATE ORDER 451 IMPOSES UNREASONABLE BURDENS AND UNREASONABLE UNCERTAINTY ON THE NATURAL GAS INDUSTRY AND COULD LEAD TO UNFAIR CONSEQUENCES NOT REASONABLY FORESEEABLE FROM A THOROUGH EXAMINATION OF THE STATUTE

Members of a free society are entitled to clarity and certainty to the maximum possible extent in matters that shape their lives, govern their actions, measure their satisfaction of obligations, and enable the realization of their rights. In order to function productively in our modern society, individuals and businesses must be able to determine what is expected of them in the enterprises and endeavors in which they are engaged. For every entity involved in a federally regulated industry, applicable statutes enacted by Congress constitute an important part of the legal framework governing such involvement.

Individuals and businesses relied in good faith on Order 451 in structuring and restructuring their dealings with one another. Just as they have a right to expect that other parties will honor the contracts they have negotiated, so do they have a right to expect that the legal framework put in place by Congress will be honored. If the court order vacating Order 451 is allowed to stand, then the disruption in the affairs of thousands of citizens will be a direct result of their misplaced reliance on the actions taken by the Commission in carrying out clear directives of the Congress contained in Sections 104(b)(2) and 106(c) of the NGPA.

The decision rendered by the majority of the court of appeals brings into sharp focus an issue of fundamental importance: Should producers, pipelines, consumers, and others have relied on the Commission's action in issuing Order 451 and, indeed, should regulated industries ever comfortably rely upon similar agency actions when the possibility of potentially contrary legislative history lurks somewhere in a statute's pre-enactment background? If, in issuing Order 451, the Commission had "made a blunder so large" that it was obvious the courts must correct it, as Respondents contend, Brief of Respondents, United Distribution Companies, *et al.*, for Certiorari at 19, then only parties who were extremely foolish or naive would have acted in reliance thereon.

The parties that structured their dealings and relationships based on reliance on Order 451 were neither foolish nor naive. They relied on the Commission's well-considered and painstakingly documented action in full knowledge that the Commission was the governmental agency to which Congress had delegated

primary jurisdiction over natural gas pricing. Likewise, the parties were fully aware that Congress had given the Commission clear and express authority, through Sections 104(b)(2) and 106(c) of the NGPA, to raise ceiling prices of old gas, so long as the new ceiling prices were "just and reasonable," as that standard has been variously applied by the Commission under the NGA. 51 Fed. Reg. 22,179 (1986) (Commission conclusion as to authorization for ceiling price increases); *see also Mobil Oil Co. v. FPC*, 417 U.S. 283, 308 (1974); *Permian Basin Area Rate Cases*, 390 U.S. 747, 775-777, 790, 799-800 (1968); *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944); *FPC v. Natural Gas Pipeline Co.*, 315 U.S. 575, 586 (1942) (just and reasonable standard does not require use of specific formula). The Commission expressly found that the new ceiling prices established by Order 451 were "just and reasonable." 51 Fed. Reg. at 22,182-185, 46,766-768.

Many parties involved in the natural gas industry relied on the authorized actions of the Commission, secure in the belief that courts would adhere to the plain language of the NGPA, or, at least, pay great deference to Order 451 since that order was promulgated in accordance with the express authority delegated by the Congress.

Further, the parties acting in such reliance were neither naive nor foolish in placing their faith in the clear language of the statute rather than isolated fragments of legislative history. As the Court has held from *Caminetti* to *Locke*, legislative history is not even to be considered by courts interpreting statutes when the language of the statute is clear. *Caminetti v. United States*, 242 U.S. 470, 490 (1917) ("If the words are plain, they give meaning to the act, and it is neither the

duty nor the privilege of the courts to enter speculative fields in search of a different meaning."); *United States v. Locke*, 471 U.S. 84, 95 (1985) ("the fact that Congress might have acted with greater clarity or foresight does not give the courts a *carte blanche* to redraft statutes in an effort to achieve that which Congress is perceived to have failed to do").

This "plain meaning rule" has not only been the law of the land for generations, but is also the course dictated by simple logic, basic fairness, and our tripartite form of government. *Tennessee Valley Authority v. Hill*, 437 U.S. 153, 194 (1978) (Congress to "formulate legislative policies . . . Executive to administer the laws . . . courts to enforce them").

Given that many members of Congress who vote for a bill will not have any of their thoughts about that bill on the record and that some may even be voting "in spite of," rather than "because of" the statements which others have placed on the record, the only fact that can be ascertained with any certainty is that all members voting for the bill were in sufficient agreement with the *language of the bill* to place their name on the indelible record of Congress as having voted for the bill. While *statements* made can later be clarified, or even retracted, *votes* are permanent and votes are for or against the language of the statute.[9]

[9] *Immigration and Naturalization Service v. Cardoza-Fonseca*, 480 U.S. 421, 453 (1987) (Scalia, J., concurring in the judgment) ("Where the language of those laws is clear, we are not free to replace it with an unenacted legislative intent."); *see also Edwards v. Aguillard*, 482 U.S. 578, 637 (1987) (Scalia, J., dissenting) (providing a purportedly non-exhaustive list of 12 potential reasons a legislator may have voted for a statute, none of which would be ascertainable from legislative history).

Businessmen are put on notice by the acts of Congress, and by the regulations issued by the duly designated agencies given rule-making and other administrative authority by Congress, that there are certain governmental requirements to which their actions must conform. When these governmental requirements are expressed in agency regulations, those regulations provide the background for all business decisions and actions that fall within their scope. The best laws and regulations are the ones which are the easiest to interpret and apply, since all parties to a business transaction may then be more confident that the decisions they make and actions they take are based on the same background of information.

Charging businessmen with interpretation of not only the statutes and regulations pertaining to business transactions, but also the subjective intent of different members of the Congress -- often vaguely expressed by mere floor debate preceding the enactment of the laws which gave rise to the regulations -- is manifestly contrary to the rule of law. Even the courts, which enjoy the luxury of an adversarial presentation and are blessed with an amount of time which is not tied to the exigencies of the world of business and industry to arrive at a decision, are quite correctly reluctant to consider mere political rhetoric in statutory construction of laws which are clear on their face. Holmes, *supra* note 3 ("We do not inquire what the legislature meant; we ask only what the statute means.").[10]

[10] *See also Immigration and Naturalization Service v. Cardoza-Fonseca*, 480 U.S. 421, 452-53 (1987) (Scalia, J., concurring) (criticizing "exhaustive analyses" of legislative history "where the language of the enactment at issue is clear."); *Schwegmann Brothers v. Calvert Distillers Corp.*, 341 U.S. 384, 395 (1951) (Jackson, J., concurring) ("Resort to legislative history is only justified where the face of the act is inescapably ambiguous.").

Certainly, the courts do not want to further burden the already overloaded judicial system by encouraging litigation that results when affected parties try to guess the intent of Congress, act upon their best guess, and then resort to the courts for an adjudication when other parties to their transactions had operated under different expectations regarding congressional intent. As unfit to determine the subjective intentions of Congress as the courts have claimed to be, businessmen can justifiably claim to be even more unfit to accomplish this task.

The need for certainty in the rules governing business transactions is even greater today than in times past. The inherent risks of producer participation in the natural gas industry are extensive enough without the potential for the disruption of years of transactions by the subsequent reinterpretation, based on mere political rhetoric, of laws that are clear on their face. Shadowy fragments of legislative history provide an exceedingly shaky foundation for making business decisions; they provide even weaker basis for courts to cause extensive disruptions to the commerce of an entire industry.

All citizens must rely on and follow rules as they exist. Businessmen must rely on these agency regulations without waiting years for each one to be interpreted, or reinterpreted, by the courts. This Court has long recognized the critical relationship between businesses and the agencies that regulate them and has sought to increase the ability to rely on agency actions by instructing courts to pay great deference to agency determinations, except where the agencies have violated the clear and express intent of Congress. *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842-844 (1984); *K Mart Corp. v. Cartier, Inc.*, 486 U.S. 281, 292 (1988). The confidence that

businessmen can place in agency determinations helps pave the path of the nation's commerce. Vacating Order 451 would place a sign on this path cautioning businesses to proceed at their own risk, or not at all, until or unless applicable statutory enactments and duly promulgated regulations have been measured against fragments of legislative history not a part of the statutory enactment itself.

III. THE COURT OF APPEALS IGNORED BINDING PRECEDENT OF THIS COURT BY REFUSING TO GIVE DEFERENCE TO COMMISSION ACTION WHEN THE LEGISLATIVE INTENT OF THE NGPA WAS PUT IN ISSUE BY THE CONFLICT BETWEEN STATUTORY LANGUAGE AND LEGISLATIVE HISTORY

The majority decision of the court below fails to even mention *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), or the standard of judicial review enunciated in that case. When an agency has interpreted a statute, *Chevron* requires the reviewing court to first determine "whether Congress has directly spoken to the precise question at issue." *Chevron*, 467 U.S. at 842. If so, the court, as well as the agency, "must give effect to the unambiguously expressed intent of Congress." *Id.* at 842-43. If not, that is, "if the statute is silent or ambiguous," *id.* at 843, the court must defer to the interpretation of the agency, unless it is clearly unreasonable. *Id.* at 845. Had the majority below applied *Chevron's* two prong test for determining the validity of Order 451, it would have been forced to hold that Order 451 is a valid regulatory implementation of NGPA Sections 104(b)(2) and 106(c).

As to the first prong of the *Chevron* test, the "precise question" presented in the court below was whether the Congress empowered the Commission to raise the ceiling prices of all old gas vintages, provided that the new ceiling prices selected satisfied the Natural Gas Act's standard of "just and reasonable." Congress provided, through the plain language of Sections 104(b)(2) and 106(c), an unambiguous affirmative answer to that question. The majority below would have had to reach that same conclusion but for use of dubiously relevant legislative history to achieve a result that is in conflict with the statute's plain language.

Even if the majority were correct in ignoring the language of the statute, the court's inquiry would not be at an end; the *reasonableness* of Order 451 as the Commission's interpretation of NGPA Sections 104(b)(2) and 106(c) would then need to be addressed. This "second prong" of the *Chevron* test requires that the court defer to reasonable agency action.

When the second prong of the *Chevron* test is required, the court is not free to construe the statute as if writing on a clean slate. The court's scope of review is very limited indeed, that being solely to determine "whether the agency's answer is based on a permissible construction of the statute." *Id.* at 843 (citations omitted). "If the agency regulation is not in conflict with the plain language of the statute, a reviewing court must give deference to the agency's interpretation of the statute." *K Mart*, 486 U.S. at 292, citing *United States v. Boyle*, 469 U.S. 241, 246 n.4 (1985).

In this case, when the deference to reasonable agency action required by *Chevron* and *K Mart* is accorded Order 451, it must be found to be a valid Commission regulation pursuant to the delegation of

authority found in Sections 104(b)(2) and 106(c) of the NGPA.

CONCLUSION

The plain language of Sections 104(b)(2) and 106(c) clearly authorized the Commission to raise old gas prices in the manner adopted by the Commission in Order 451. The court of appeals ignored the plain language of the statute and relied, instead, upon fragments of legislative history to hold that the Commission had exceeded its authority relating to pricing of old gas. In so doing, the court of appeals violated important principles of law, requiring that its holding be reversed.

Amicus respectfully requests that the judgment of the court of appeals be reversed.

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